



Construction Contract Clause Digest

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Construction Law Committee

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Pre-Contract Requirements Site Inspections, Review Of Contract Documents and Representations

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In 2007, the American Institute of Architects (AIA) introduced new versions of its A101 owner-contractor agreement and the general conditions for construction, the A201. A new family of documents known as ConsensusDocs was also introduced in 2007. The ConsensusDocs 200 form is the ConsensusDocs *Standard Form Agreement and General Conditions between Owner and Contractor*. The Engineering Joint Contract Documents Committee (EJCDC) has also released a new version of its suggested form of agreement between owner and contractor—stipulated sum (the “C-520”) and the general conditions for construction (the “C-700”).

Significance of the Clauses

Pre-contract site inspections and review of Contract Documents and representations are arguably some of the most important aspects of any construction project. Careful consideration of site conditions and geotechnical inspection reports insulate the contractor from potential liability for change orders, delay clauses, and payment for post construction remediation efforts. The owner undertakes a duty of disclosure, which, if made accurately and timely, may shield the owner from liability and shift the responsibility to the contractor.

Sample Clauses:

AIA “Review of Contract Documents and Field Conditions” (2007):

§3.2.1 Execution of the Contract by the Contractor is a representation that the Contractor has visited the site, become generally familiar with local conditions under which the Work is to be performed, and correlated personal observations with requirements of the Contract Documents.

Contractor will also be representing by its extension of the Contract, or, if the Construction manager at Risk delivery method is used, by execution of the Amendment to the Contract establishing the Contract Time, Contract Sum, and the Guaranteed Maximum Price, that the Contractor has thoroughly reviewed all of the Contract Documents and that based on such review and to the best knowledge of Contractor as a contractor, not as a design professional, that said Contract Documents are sufficient to enable the Contractor to determine the Contract Sum, the Contract Time, and the Guaranteed Maximum Price, and that that the Contract Documents are sufficient to enable it to perform the Work described in the Contract Document, and otherwise to fulfill all its obligations hereunder in accordance with the terms of the Contract. The Contractor further acknowledges and declares that it has visited and examined the site (but only as to visible surface conditions or conditions ascertainable from the results of any subsurface tests required or provided in connection with this Project, or other reports and documents available to the Contractor) and reasonably examined the physical, legal and other conditions affecting the Work including, without limitation, all soil, subsurface, water, survey and engineering reports and studies delivered to or obtained by

Contractor and the conditions described in this Section 3.2.1. in connection therewith, Contractor by execution of the Contract and the Amendment establishing the Contract Sum, Contract Time and Guaranteed Maximum Price will be representing and warranting to Owner that it has, by careful examination, satisfied itself as to the conditions and limitations under which the Work is to be performed, including, without limitation, (1) the location, layout and nature of the Project site and surrounding areas, (2) generally prevailing climatic and weather conditions, (3) anticipated labor supply and costs, (4) availability and cost of materials, tools and equipment and (5) other similar issues. In arriving at the Contract Sum, Guaranteed Maximum Price and the Contract Time, Contractor has, as an experienced and prudent manager and contractor, exercised its reasonable judgment and expertise to include the impact of such circumstances upon the Contract Sum and the Contract Time.

1. Claims for additional compensation or time because of the failure of the Contractor to familiarize itself with visible surface conditions at the site or other conditions under which the Work is to be performed will not be allowed.
2. The Owner assumes no responsibility or liability for the physical condition or safety of the Project site or any improvements located on the Project Site. The Contractor shall be solely responsible for providing a safe place for the performance of the Work. The Owner shall not be required to make any adjustment in either the Contract Sum, Guaranteed Maximum Price, if applicable, or Contract Time in connection with any failure by the Contractor or any Subcontractor to comply with the requirements of this Section 3.2.
3. Contractor represents that the Subcontractors, manufacturers and suppliers engaged or to be engaged by it are and will be familiar with the requirements for performance by them of their obligations. All contracts with subcontractors and suppliers shall be in writing, and shall reflect the terms of this Contract which directly or indirectly affect subcontractors or suppliers, including Owner's right to withhold payment, retainage requirements, and Owner's rights and liability on termination of this Contract. Contractor shall require compliance with the terms and provisions of the Contract Documents applicable to them, including, without limitation, the requirement for subcontractors to comply with the prevailing wage rates established in the Contract, to maintain worker's compensation coverage on employees, and to provide certification of such coverage to Contractor.

§3.2.2 Because the Contract Documents are complementary, the Contractor shall, before starting each portion of the Work, carefully study and compare the various Contract Documents relative to that portion of the Work, as well as the information furnished by the Owner pursuant to Section 2.2.3, shall take field measurements of any existing conditions related to that portion of the Work, and shall observe any conditions at the site affecting it. These obligations are for the purpose of facilitating coordination and construction by the Contractor. In addition, as part of Contractor's preconstruction services, in reviewing the Contract Documents, Contractor shall endeavor to detect any errors, omissions, or inconsistencies in the design and other documents which affect the performance or constructability of the Work. Contractor shall promptly report to the Architect any errors, inconsistencies or omissions discovered by or made known to the Contractor as a request for information in such form as the Architect may require. It is recognized that the Contractor's review is made in the Contractor's capacity as a contractor and not as a licensed design professional, unless otherwise specifically provided in the Contract Documents.

§3.2.3 The Contractor is not required to ascertain that the Contract Documents are in accordance with applicable laws, statutes, ordinances, codes, rules and regulations, or lawful orders of public authorities, except to the extent that the Contractor knows or should reasonably know about an inconsistency between the Contract Documents and applicable law, and the Contractor shall promptly report to the Architect any nonconformity discovered by or made known to the Contractor as a request for information in such form as the Architect may require.

§3.2.4 If the Contractor believes that additional cost or time is involved because of clarifications or instructions the Architect issues in response to the Contractor's notices or requests for information pursuant to Sections 3.2.2 or 3.2.3, the Contractor shall notify the Owner prior to incurring such additional cost or expending such additional time, or if Contractor cannot reasonably provide notice prior to incurring costs or expending additional time, then as soon thereafter as reasonably possible, and may make Claims as provided in Article 15. If the Contractor fails to perform the obligations of Sections 3.2.2 or 3.2.3, the Contractor shall pay such costs and damages to the Owner as would have been avoided if the Contractor had performed such obligations. If the Contractor performs those obligations, the Contractor shall not be liable to the Owner or Architect for damages resulting from errors, inconsistencies or omissions in the Contract Documents, for differences between field measurements or conditions and the Contract Documents, or for nonconformities of the Contract Documents to applicable laws, statutes, ordinances, codes, rules and regulations, and lawful orders of public authorities, except to the extent that Contractor should have detected such errors, omissions, discrepancies, inconsistencies, conflicts or differences as part of Contractor's performance of its obligations under the Contract Documents, including the performance of Contractor's preconstruction services.

§3.2.5. Contractor shall confirm the location of each utility, shall excavate and dispose of each on-site utility and shall cap offsite utility as required by the Work and as may be included in the Specifications and in conformance with the rules and requirements of the affected utility provider. At the Owner's request, the Contractor shall make available the results of any site investigation, test borings, analyses, studies or other tests conducted by or in possession of the Contractor or any of its agents, subject to the terms of this subsection. The Contractor represents that it is generally familiar with the Project site. The Contractor shall exercise due care in executing subsurface work in proximity of known subsurface utilities, improvements, and easements. Nothing in this section shall be read or construed as limiting the responsibilities of the Contractor or its Subcontractors pursuant to Section 3.2.

Consensus DOCS 200 "Standard Agreement and General Conditions between Owner and Contractor"

3.2 COOPERATION WITH WORK OF OWNER AND OTHERS

3.2.4 Before proceeding with any portion of the Work affected by the construction or operations of the Owner or Others, the Constructor shall give the Owner prompt written notification of any defects the Constructor discovers in their work which will prevent the proper execution of the Work. The Constructor's obligations in this subsection do not create a responsibility for the work of the Owner or Others, but are for the purpose of facilitating the Work. If the Constructor does not notify the Owner of defects interfering with the performance of the Work, the Constructor acknowledges that the work of the Owner or Others is not defective and is acceptable for the proper execution of the Work. Following receipt of written notice from the Constructor of defects,

the Owner shall promptly inform the Constructor what action, if any, the Constructor shall take with regard to the defect.

3.3 RESPONSIBILITY FOR PERFORMANCE

3.3.1 Prior to commencing the Work the Constructor shall examine and compare the drawings and specifications with information furnished by the Owner that are Contract Documents, relevant field measurements made by the Constructor, and any visible conditions at the Worksite affecting the Work.

3.3.2 Should the Constructor discover any errors, omissions or inconsistencies in the Contract Documents, the Constructor shall promptly report them to the Owner. It is recognized, however, that the Constructor is not acting in the capacity of a licensed design professional, and that the Constructor's examination is to facilitate construction and does not create an affirmative responsibility to detect errors, omissions or inconsistencies or to ascertain compliance with applicable laws, building codes or regulations. Following receipt of written notice from the Constructor of defects, the Owner shall promptly inform the Constructor what action, if any, the Constructor shall take with regard to the defects.

Practice Notes

Concealed Subsurface Conditions

A comprehensive investigation of subsurface conditions (e.g. soil boring logs and/or a geotechnical report) before the design and construction of a project is generally considered a worthwhile investment that will, for the most part, eliminate surprises and costly change orders to the construction contract. Sometimes, even the most comprehensive investigation does not eliminate all surprises during performance of the construction contract and the Owner, Engineer and Architect must decide how to allocate the risk for such unanticipated subsurface conditions. If the risk is shifted to the Contractor, the Contractor could add a contingency clause to the contract allowing an adjustment to its bid price to cover the risk of such unforeseen conditions. By adding a Concealed or Unknown Conditions clause to the construction contract, however, the Owner can accept the risk and agree to issue the contractor a change order in the event such unforeseen conditions are encountered.

If the Owner decides to accept the risk for unforeseen subsurface conditions, there are many ways to address this in the construction contract. For example, AIA Document A201 – 2007 provides the following clause covering changed conditions:

§3.7.4 If the Contractor encounters conditions at the site that are (1) subsurface or otherwise concealed physical conditions that differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, that differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, the Contractor shall promptly provide notice to the Owner and the Architect before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if the Architect determines that they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable

adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall promptly notify the Owner and Contractor in writing, stating the reasons.

However, a contract may allocate the risk of unforeseen conditions to the contractor. Where a disclaimer purports to waive the contractor's right to rely on third-party reports not otherwise a part of the Contract Documents, the contractor may not then cite unforeseen conditions contrary to those reports as cause for delay or additional costs. *Millgard Corp. v. McKee/Mays*, 49 F.3d 1070 (5th Cir. 1995). Unless so determined, a third-party report (soil log or other) is not necessarily a warranty of subsurface conditions.

Misrepresentations By Owner

A site owner has a duty to disclose pertinent information to a contractor, and may not mislead the contractor or conceal material facts. Where a site owner does not disclose facts which subsequently cause delay for abatement of the condition or reengineering a solution to same, the contractor will likely be entitled to recover under the differing site condition (DSC) clause. *S. Cal. Edison v. United States*, 58 Fed. Cl. 313 (Fed. Cl. 2003). However, a contractor may not claim that a site owner withheld superior knowledge where there were other available sources of information which the contractor failed to consult. See, e.g., *Manuel Bros., Inc. v. U.S.*, 55 Fed. Cl. 8, 35 (Fed. Cl. 2002).

Contractor Site Inspection

Contractors are usually required to closely review all contract documents, conduct a site investigation, and exercise reasonable judgment based upon professional experience. Under Section 3.2.1 of AIA Document A201-2007, by signing the contract the contractor may represent that it has visited the site, is familiar with the site conditions, and reviewed the documentation relevant to the project.

A contractor's site inspection must be reasonable, but not necessarily to the highest degree of scientific analysis. A contractor is presumed to have knowledge of conditions that a "reasonable" pre-bid or pre-contract site visit would reveal. A contractor may recover if the DSC could not have been or was not discovered by reasonable investigation. A contractor is typically not required to take unusual or extraordinary measures to investigate site conditions. *Pitt-Des Moines, Inc.*, 96-1 B.C.A. (CCH) P27,941 (A.S.B.C.A. Sept. 26, 1995). But a contractor who does not properly investigate the site may not be able to claim relief under a DSC clause. *Southern Comfort Builders, Inc.*, Fed. Cl. 124, 137 (Fed. Cl. 2005).

Differing/Unanticipated Site Conditions

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Significance of the Clause:

Differing site condition ("DSC") clauses relate to construction site conditions which are materially different from those ordinarily encountered during construction and/or from conditions described and specified in the contract documents. Such clauses affect the owner by binding contractors to perform the work under typical construction conditions or conditions envisioned by the project documents. Such clauses affect the contractor by providing a possible remedy and a potential contract cost adjustment if unexpected conditions are encountered during construction.

Sample Clauses:

AIA "General [Contract] Conditions" (2007)©:

3.7.4. Concealed or Unknown Conditions. If the Contractor encounters conditions at the site that are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inherent in construction activities of the character provided for in the contract Documents, the Contractor shall promptly provide notice to the Owner and Architect before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both... (Published by the American Institute of Architects).

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3.16.2 CONCEALED OR UNKNOWN SITE CONDITIONS. If the conditions at the Worksite are (a) subsurface or other physical conditions which are materially different from those indicated in the Contract Documents, or (b) unusual or unknown physical conditions which are materially different from conditions ordinarily encountered and generally recognized as inherent in Work provided for in the Contract Documents, the Contractor shall stop Work and give immediate written notice of the condition to the Owner and the architect/Engineer. ... (Published by Consensus DOCS).

Federal Acquisition Regulations 52.236-2, "Differing Site Conditions (Apr 1984)":

a) The Contractor shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer of (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual

nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract...,

Practice Notes:

Type I DSC

A Type I differing site condition occurs where site conditions differ from the contract specifications. The contractor must show that conditions "...differed materially from those expressly or impliedly indicated in the contract", and resulted in an increase in time or cost of performance. *Servidone Constr. Corp. v. U.S.*, 19 Cl. Ct. 346 (Cl. Ct. 1990). An owner may be required to provide a cost adjustment if: (1) the conditions indicated in the contract differed materially from actual conditions; (2) the actual conditions were unforeseeable, based upon the information available at the time of bidding; (3) the contractor reasonably relied on the contract documents; and (4) the contractor incurred additional time or costs as a result.

Type II DSC

A Type II differing site condition occurs where conditions differ from usual construction conditions. A claimant must show that it "...encountered an unknown physical [condition] at the site, of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inhering in the work." *Servidone Constr. Corp. v. U.S.*, 19 Cl. Ct. 346 (Cl. Ct. 1990). An owner may be required to provide a cost adjustment if the contractor could not reasonably have anticipated the actual site conditions based upon inspection and general experience, and the actual conditions varied from the norm for similar contracting work or that geographic area.

Physical Conditions Only

A DSC clause "...applies only to physical conditions at the work site, not to the actions of third-parties that deny the contractor access to the work site." *Olympus Corp. v. U.S.*, 98 F.3d 1314 (Fed. Cir. 1996). In *Olympus Corp.*, the court rejected a contractor's argument that the DSC clause applied to a labor strike which delayed the construction.

Contractor Site Inspection

Contractors are usually required to closely review all contract documents, conduct a site investigation, and exercise reasonable judgment based upon professional experience. Under Section 3.2.1 of AIA Document A201-2007, and many other contracts, by signing the contract the contractor may represent that it has visited the site, is familiar with the site conditions, and reviewed the documentation relevant to the project.

A contractor's site inspection must be reasonable, but not necessarily to the highest degree of scientific analysis. A contractor is presumed to have knowledge of conditions that a "reasonable" pre-bid or pre-contract site visit would reveal. A contractor may recover if the DSC could not have been or was not discovered by reasonable investigation. A contractor is typically not required to take unusual or extraordinary measures to investigate site conditions. *Pitt-Des Moines, Inc.*, 96-1 B.C.A. (CCH) P27,941 (A.S.B.C.A. Sept. 26, 1995)

Notice

A typical DSC clause requires the contractor to promptly notify the owner upon encountering and before correcting a condition. Where a contractor fails to give prompt notice, courts may consider whether the owner was prejudiced by any lack of notice. An owner is not prejudiced by a failure to notify if the owner has actual knowledge of the DSC. *Ronald Adams Contractor, Inc. v. Miss. Transp. Corn'n*, 777 So.2d 649 (Miss. 2000).

Owner Misrepresentation or Concealment

An owner has a duty to disclose pertinent information to a contractor, and may not mislead or conceal material facts about a project or work site. *S. Cal. Edison v. United States*, 58 Fed. Cl. 313 (Fed. Cl. 2003); *Robert W Carlstrom Co., Inc. v. German Evangelical Lutheran St. Paul's Congregation*, 662 N.W.2d 168 (Minn. Ct. App. 2003).

Changes and Change Orders

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Significance of the Cause:

The construction contract between the owner and contractor sets forth the contractor's performance obligations, but the parties need flexibility to adapt the contract to actual construction conditions. Although traditional contract law permits parties to modify or change their contract by mutual agreement, in construction contracts the owner needs to be able to unilaterally change the contract to accomplish the underlying purposes of the project. The contractual mechanism for handling contract modifications, and claims for extra work in connection with them, is the "Change Order" ("CO") clause.

A CO is a written authorization to a contractor approving a change from original plans, specifications, and other contract documents. A CO often authorizes an increase or decrease in contractor compensation or time to perform.

The CO clause entitles the owner to unilaterally direct changes in the work without the contractor's consent and without breaching the contract, provided the change is within the general scope of the contract. For a proposed change to be "within the general scope" of the contract, the change in work must be regarded as fairly and reasonably within the contemplation of the parties when they entered into the contract. In exchange for the owner's right to direct changes, the contractor is entitled to receive additional compensation for the changes or extra work, or there will be an appropriate deletion.

Sample Clauses:

Article 7 of the AIA A201 General Conditions of the Contract for Construction©:

§ 7.1.1 Changes in the Work may be accomplished after execution of the Contract, and without invalidating the Contract, by Change Order, Construction Change Directive or order for a minor change in the Work, subject to the limitations stated in this Article 7 and elsewhere in the Contract Documents.

§ 7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor, and Architect; a Construction Change Directive requires agreement by the Owner and Architect and may or not be agreed to by the Contractor; an order for a minor change in the Work may be issued by the Architect alone.

§ 7.2.1 A Change Order is a written instrument prepared by the Architect and signed by the Owner, Contractor, and Architect, stating their agreement upon all of the following:

- 1) the change in the Work;
- 2) the amount of the adjustment, if any, in the Contract Sum; and

- 3) the extent of the adjustment, if any, in the Contract Time.

§ 7.3.3 If the Construction Change Directive provides for an adjustment to the Contract Sum, the adjustment shall be based on one of the following methods:

- 1) mutual acceptance of a lump sum properly itemized and supported by sufficient substantiating data to permit evaluation;
- 2) unit prices stated in the Contract Documents or subsequently agreed upon;
- 3) cost to be determined in a manner agreed upon by the parties and a mutually acceptable fixed or percentage fee; or
- 4) as provided in Section 7.3.7.

§ 7.3.5 Upon receipt of a Construction Change Directive, the Contractor shall promptly proceed with the change in the Work involved and advise the Architect of the Contractor's agreement or disagreement with the method, if any, provided in the Construction Change Directive for determining the proposed adjustment in the Contract Sum or Contract Time.

The AIA© documents identify three different types of possible changes: (1) Formal Change Orders, agreed upon and signed by both the owner and the contractor; (2) Construction Change Directives, signed only by the owner; and (3) Field Orders, signed by the architect for only minor changes in the work.

ConsensusDOCS© refer primarily to two situations, the Change Order and the "Interim Directed Change" –

§ 8.1 CHANGE ORDER — § 8.1.1 The Contractor may request or the Owner may order changes in the Work or the timing or sequencing of the Work that impacts the Contract Price or the Contract Time. All such changes in the Work that affect Contract Time or Contract Price shall be formalized in a Change Order. Any such requests for a change in the Contract Price or the Contract Time shall be processed in accordance with this Article 8.

§ 8.1.2 The Owner and the Contractor shall negotiate in good faith an appropriate adjustment to the Contract Price or the Contract Time and shall conclude these negotiations as expeditiously as possible. Acceptance of the Change Order and any adjustment in the Contract Price or Contract Time shall not be unreasonably withheld.

§ 8.2 INTERIM DIRECTED CHANGE - § 8.2.1 The Owner may issue a written Interim Directed Change directing a change in the Work prior to reaching agreement with the Contractor on the adjustment, if any, in the Contract Price or the Contract Time.

§ 8.2.2 The Owner and the Contractor shall negotiate expeditiously and in good faith for appropriate adjustments, as applicable, to the Contract Price or the Contract Time arising out of an Interim Directed Change. As the Changed Work is performed, the Contractor shall submit its costs for such work with its application for payment beginning with the next application for payment within thirty (30) Days of the issuance of the Interim Directed Change. If there is a dispute as to the cost to the Owner, the Owner shall pay the Contractor fifty percent (50%) of its estimated cost to perform the work. In such event, the Parties reserve their rights as to the disputed amount, subject to the requirements of Article 12.

Under ConsensusDOCS®, the Owner must pay the Contractor 50% of the estimated cost to complete the disputed work, whereas no such obligation exists under the AIA forms. This is an added protection and leverage for the Contractor, but can also benefit the Owner by insuring that the project can move forward while the parties negotiate details.

Federal Acquisition Regulations - § 52.243-5 Changes and Changed Conditions

CHANGES AND CHANGED CONDITIONS –

- a) The Contracting Officer may, in writing, order changes in the drawings and specifications within the general scope of the contract.
- b) The Contractor shall promptly notify the Contracting Officer, in writing, of surface or latent physical conditions differing materially from those indicated in this contract or unknown unusual physical conditions at the site before proceeding with the work.
- c) If changes under paragraph (a) or conditions under paragraph (b) increase or decrease the cost of, or time required for performing the work, the Contracting Officer shall make an equitable adjustment (see paragraph (d) upon submittal of a proposal for adjustment (hereafter referred to as proposal) by the Contractor before final payment under the contract.
- d) The Contracting Officer shall not make an equitable adjustment under paragraph (b) unless—
 - 1) The Contractor has submitted and the Contracting Officer has received the required written notice; or
 - 2) The Contracting Officer waives the requirement for the written notice.
- e) Failure to agree to any adjustment shall be a dispute under the Disputes clause.

Practice Notes:

Elements for Recovery

Even if a CO or change directive is executed, recovery for extra work may be barred unless the contractor can show that it in fact performed work over and above what was required under the original contract. The contractor must establish the following points to obtain additional compensation for extra work:

- 1) the work was outside the scope of the original contract,
- 2) the extra items or changes were ordered at the direction of the owner,
- 3) the owner either expressly or impliedly agreed to pay extra,
- 4) the extra items were not furnished voluntarily by the contractor, and
- 5) the extra items were not required or made necessary through any fault or omission of the contractor. *Duncan v. Cannon*, 561 N.E.2d 1147 (Ill. App. Ct. 1st Dist. 1990).

Notice & Timing

The typical CO clause requires written authorization for the change before commencement of changed work. The general rule remains that the contractor who performs work without a written directive to do so when the contract requires a written CO may not have a legally enforceable claim.

However, written approvals and general directions to proceed may be sufficient to sustain a claim even if the strict change order protocol was not followed. See, e.g., *ASA of New York, Inc. v. Anchor Construction, Inc.*, 21 A.D.3d 836, 801 N.Y.S.2d 308 (1st Dept. 2005). The key points of proof and evidence are to establish the owner's request/direction to change the work and agreement to pay for extra work. See, e.g., *Duncan v. Connor*, *supra*. However, any "waiver" of the contract CO procedure may be disputed, unclear, and subject to a very high level of proof. See, e.g., *Travelers Casualty and Surety Co. v. White Plains Public Schools*, 2007 U.S. Dist. LEXIS 98510 (S.D.N.Y. 2007). Oral changes and modifications may be enforceable even if a contract has a clause precluding oral modifications. *EMCO Tech Construction Corp. v. Pilavas*, 2008 N.Y. Misc. LEXIS 8360 (Sup. Ct. Nassau Co. 2008).

Drafting Tips

One drafting consideration from the owner's perspective is to include a requirement that the contractor commence and continue performance, including any changed work, pending necessary modifications or amendments to the contract price or time. Standard contract language typically provides the owner with the right to order the contractor to proceed with disputed work, unless the work is so far beyond the scope of the contract as to constitute a cardinal change.

From the contractor's perspective, it is important to articulate who has authority on behalf of the owner to direct and approve changes in the work. The contract should include a clear designation of authority, and a mechanism that permits the contractor to verify authorization of a change or extra work order without violating any contractual duty or direction to proceed with disputed work.

Generally, even if the contractor disputes an ordered change, it must proceed with the work and seek recourse through the contract's respective claims and disputes provisions.

Standard of Proof

Some courts have held that a contractor's extra work claim must be proven by a higher evidentiary standard — clear and convincing evidence. *Duncan v. Cannon*, *supra*.

There Must Be Extra Work

Labor and materials which are incidental and necessary to performance of the contract cannot be regarded as extra work for which a contractor or builder may recover. Likewise, "general" or undocumented discussions may be inadequate to prove and present a CO claim.

Time May Also Be Affected

The presence or absence of CO's may have a bearing not only on price and cost, but may also affect time of completion to shorten or extend time allowed for the substantial completion and final completion of the work.

Change Order or Change Directive?

Watch out for proposals or plans originally presented by a party as a CO, for which mutual agreement is required, but if agreement is lacking the same or similar work and changes are then cast or re-labeled as a "Construction Change Directive" or an "Interim Directed Change."

Does Extra Work Allowance Include Contractor Overhead and Profit?

Be sure to review and determine whether the CO provision, and any CO proposed and agreed upon, includes allowance for contractor overhead and profit (added or deleted), implicitly or explicitly.

Reservation of Rights

An owner, architect or engineer in charge may issue and approve a CO with a reservation of rights. Sample language would be that, "Neither this Change Order nor the extension of time of performance granted hereunder, constitute an admission that Owner is responsible for any delays or hindrance to past or future work under the contract." *Travelers Casualty and Surety Company v. Dormitory Authority — State of New York*, 2010 U.S. Dist. LEXIS 88320 (S.D.N.Y. 2010).

Worker and Job Site Safety

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Jobsite safety is primarily the responsibility of the general contractor, as it is deemed to have control over its employees and the job site and is the coordinator of the project. Typical contract provisions, such as the AIA's, place responsibility squarely on the general contractor. By avoiding such contract provisions and by making sure that a subcontractor is allowed to have full control over the means and methods of its performance, a general contractor may be able to successfully shift liability for injuries suffered by employees of subcontractors to the responsible subcontractor.

Sample Clauses:

The AIA contract provisions generally place the responsibility for jobsite safety upon the general contractor. The following pertinent provisions are from the AIA Document A201 (2007):

§ 3.3.1: "The Contractor shall be solely responsible for, and have control over, construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work under the Contract, unless the Contract Documents give other specific instructions concerning these matters. If the Contract Documents give specific instructions concerning construction means, methods, techniques, sequences or procedures, the *Contractor shall evaluate the jobsite safety thereof and, except as stated below, shall be fully and solely responsible for the jobsite safety of such means, methods, techniques, sequences or procedures.* If the Contractor determines that such means, methods, techniques, sequences or procedures may not be safe, the Contractor shall give timely written notice to the Owner and Architect and shall not proceed with that portion of the Work without further written instructions from the Architect." (emphasis added)

§5.3: "... the Contractor shall require each Subcontractor... to assume toward the Contractor all the obligations and responsibilities, including the responsibility for safety of the Subcontractor's Work, which the Contractor... assumes toward the Owner and Architect."

§10.1: "The Contractor shall be responsible for initiating, maintaining and supervising all safety precautions and programs in connection with the performance of the Contract."

§10.2.1: "The Contractor shall take reasonable precautions for safety of, and shall provide reasonable protection to prevent damage, injury or loss to... employees on the Work and other persons who may be affected thereby."

§10.2.2: "The Contractor shall comply with and give notices required by applicable laws, statutes, ordinances, codes, rules and regulations, and lawful orders of public authorities bearing on safety of persons or property or their protection from damage, injury or loss."

§10.2.3: "The Contractor shall erect and maintain, as required by existing conditions and performance of the Contract, reasonable safeguards for safety and protection, including posting

danger signs and other warnings against hazards, promulgating safety regulations and notifying owners and users of adjacent sites and utilities.”

In addition to the applicable contract provisions, worker and jobsite safety claims are governed by OSHA standards and by standards set forth by other organizations, such as the ANSI (“American National Standards Institute”), ACG (“Associated General Contractors”), and the National Safety Council. OSHA’s Safety and Health Regulations for Construction provide that a general contractor and a subcontractor are jointly responsible for subcontracted work:

“To the extent that a subcontractor of any tier agrees to perform any part of the contract, he also assumes responsibility for complying with the standards in this part with respect to that part. Thus, the prime contractor assumes the entire responsibility under the contract and the subcontractor assumes responsibility with respect to his portion of the work. With respect to subcontracted work, the prime contractor and any subcontractor or subcontractors shall be deemed to have joint responsibility.” 29 CFR 1926.16(c)

Practice Points:

A general contractor should avoid general contract language that places broad, general responsibility for safety on the general contractor, and should instead seek to include provisions that place the responsibility for the means and methods of the subcontractor’s work on the subcontractor.

Such contract provisions can alleviate some of the general contractor’s liability, but only if the general contractor allows the subcontractor to perform the work in its own way, and does not seek to control the manner in which the subcontractor completes the work. The Restatement (Second) of Torts provides that:

“One who entrusts work to an independent contractor, but who retains the control of any part of the work, is subject to liability for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care.” Restatement (Second) of Torts §414 (1965).

Comment (c) to §414 explains the “retained control element” of this provision:

“In order for the rule stated in this section to apply, the employer must have retained at least some degree of control over the manner in which the work is done. It is not enough that he has merely a general right to order the work stopped or resumed, to inspect its progress or receive reports, to make suggestions or recommendations which need not necessarily be followed, or to prescribe alterations and deviations. Such a general right is usually reserved to employers, but it does not mean that the contractor is controlled as to his methods of work, or as to operative detail. There must be such a retention of a right of supervision that the contractor is not entirely free to do the work in his own way.” Restatement (Second) of Torts §414, comment (c) at 388.

While a thorough understanding of the particular jurisdiction’s statutory and case law on the subject of general contractor / subcontractor liability is needed, a general contractor that allows a subcontractor to retain sufficient control over its work, and that is protected by appropriate contract language, may be able to pass responsibility onto that subcontractor. A contractor must keep in

mind, however, that there are always experts who will testify that safety is *always* the general contractor's responsibility.

Payment Applications and the Process

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Payment on construction projects is obviously important. Unfortunately, the downward flow of money from the Owner to the Subcontractors and Suppliers is often inhibited by the insolvency of one of the parties. The effect on the Owner, General Contractor, or Subcontractor of failing to pay down the tier are significant and include, but are not limited to (1) abandonment of the project; (2) waiver of enforcement of Contract provisions; (3) the filing of mechanics liens encumbering the title to the project, which could result in the loss of financing; (4) bankruptcy; (5) stop work liability; and (6) liquidated damages. Therefore, a good working knowledge of the Payment Application process is essential.

Payment and Application for Payment can be found in Article 9 of AIA Document A201-2007, General Conditions, which applies to the AIA Document 101-2007 Standard Form of Agreement Between Owner and Contractor. All references herein are made to AIA Document A201-2007 unless otherwise noted.

Section 9.1 of AIA 201-2007 provides that the Construction Contract Sum stated in the AIA 101 Agreement, plus authorized change orders and adjustments, is the total amount payable by the Owner to the Contractor for performance of the Work under the Contract Documents based on the Total Construction Contract Sum.

Before the first application for payment, the Contractor should prepare and submit to the Architect a "Schedule of Values" with supporting information to justify the values. The Schedule of Values specifies the portion of the Total Construction Contract Sum that is attributable to certain portions of the Work. Examples include mobilization, earth work, curbing, concrete work, steel, etc. The Schedule is an important document because it is the primary document upon which the Architect bases its reviews evaluations and calculations of the Contractor's Applications for Payment to certify them for payment by the Owner to the Contractor. If work that is performed early on in the construction process is listed in the Schedule as representing a higher percentage of the total construction cost than in reality it actually is, then it is possible for the Owner to overpay the Contractor early in the project, which could result in underfunding late in the project.

Payment Application Provision:

After establishing the Schedule of Values, the payment process is initiated by the Contractor submitting an Application for Payment to the Architect. Section 9.3.1, Applications for Payment, provides:

At least 10 days before the establishment for each progress payment, the Contractor shall submit to the Architect an itemized Application for Payment prepared in accordance with the Schedule of Values, if required under Section 9.2, for completed portions of the Work. Such Application shall be notarized, if required, and supported by such data substantiating the Contractor's right to payment as the Owner or Architect may require, such as copies of requisitions from Subcontractors and material suppliers, and shall reflect retainage if provided for in the Contract Documents.

If a lender is involved in the payment process, then the Contractor may be required to deliver its Payment Application documentation to the Owner or Architect earlier than 10 days before the date for payment. Section 9.3.1.2 further provides, that Applications for Payment shall not include requests for payment for portions of the Work for which the Contractor does not intend to pay a Subcontractor or material supplier unless the Work was performed by others whom the Contractor intends to pay. Furthermore, Section 9.3.3 provides that the Contractor warrants that title to all Work covered by the Application for Payment will pass to the Owner no later than time of payment.

Certification of Application For Payment:

After receiving the Application for Payment, the Architect is then required, under Section 9.4.1, within seven (7) days, to either issue its Certificate for Payment or provide its reasons for withholding certification. Depending upon the complexity of the project and the payment process, the Architect may require more than seven (7) days to review and evaluate the Contractor's Payment Application and support documentation. (Often on smaller projects, the certification process is eliminated and Pay Applications are sent directly to the Owner for payment.)

Among other things, the Architect may withhold its Certification for Payment in order to safeguard the Owner against defective work and other performance issues. Section 9.5.1 requires the Architect to notify the Contractor and Owner in the event that it is unable to certify payment in the amount of the Contractor's Application. Upon such notification, if the Contractor and Architect cannot agree on a revised amount, the Architect is required to issue certification for the amount the Architect is able to represent to the Owner that is due, based upon the limited evaluation of the Contractor's work. When and if the reasons for withholding certification are removed, the Architect is required to certify the amounts previously withheld.

Once the Architect has issued a Certificate for Payment, the Owner, under Section 9.6.1, is required to make payment in the manner and within the time provided in the Contract Documents. Likewise, the Contractor under Section 9.6.2 is required to promptly pay subcontractors upon receipt of payment from the Owner and Subcontractors, who in turn, are required to pay Sub-Subcontractors upon payment. Thus, this provision was intended to make sure that those Contractors and Subcontractors up the payment tiers are not allowed to benefit by holding onto payment proceeds.

Section 9.7.1 provides that the Contractor is entitled to stop work, if, through no fault of its own, the Architect fails to issue a Certificate for Payment within seven (7) days after receipt of the Contractor's Application for Payment or if the Owner does not pay the Contractor within seven (7) days after the date established in the Contract Documents for the amount certified by the Architect.

AIA Documents G702 and G703 are the forms for the Application and Certificate for Payment that are used in most instances. The G702 Application contains a section for the Architect's certification. G703 is the continuation sheet which essentially keeps a running tally of what work has been completed and paid and what retainage is being withheld.

State Law Issues:

Significant legal issues can arise through the use of these form documents because sometimes they can conflict with State statutes which require additional information. Some state laws require a

General Contractor to submit a "sworn statement" that actually lists the name of each Subcontractor with the actual amount of each Contract. The laws of several states require that these forms be modified or that additional forms be used.

Additionally, many states have prompt payment acts, which will impose high interest fees and attorney's fees as penalties for failing to make prompt payment upon construction projects. For example, in 2005 the Kansas Legislature passed the Kansas Fairness in Private Construction Contract Act ("KFPCA"), K.S.A. 16-1801 *et seq.* That Act requires that all Contracts for private construction shall provide that payment of amounts due to a Contractor from an Owner, except retainage, shall be made within thirty (30) days after the Owner receives a timely, properly completed, undisputed Application for Payment. The Act further provides that if the Owner fails to pay a Contractor within thirty (30) days following receipt of a timely, properly completed, undisputed Application for Payment, the Owner shall pay interest to the Contractor beginning on the thirty-first (31st) day after receipt of the request for payment, computed at a rate of 18% per annum on the undisputed amount. In the event suit is filed to resolve the dispute, the losing party must pay for the prevailing party's attorney's fees and costs.

The KFPCA further provides that a Contractor shall pay its Subcontractors any amounts due within seven (7) business days of receipt of payment from the Owner, including payments of retainage, if retainage is released by the Owner. If the Contractor fails to pay the Subcontractor within seven (7) business days, the KFPCA provides that the Contractor shall pay interest to the Subcontractor beginning on the eighth (8th) business day after receipt of payment by the Contractor computed at a rate of 18% per annum on the undisputed amount.

Therefore, those involved in the construction industry should be aware that the Payment Application provisions in AIA contractual forms and other forms, are greatly affected by local State law, and should seek advice of legal counsel before beginning the Payment Application process.

Limitation of Liability Clauses

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Significance of the Clause:

Many industry form documents and custom construction contracts contain provisions shifting or limiting the respective parties' risks. One of the risk-limiting provisions seen primarily in customized or modified professional services agreements is the "limitation of liability" clause ("LoL" clause). These clauses generally establish the maximum liability or exposure of one party if there is a claim. The purpose of these clauses is to recognize the proportional role of the service provider in the project and limit their liability according to the level of compensation received under the agreement. If enforceable, the clause will serve to cap a party's liability for damages to an amount certain.

Sample Clauses:

While there is no standard AIA or industry form document which contains limitation of liability provision language, most of them are proposed as a custom term added to these documents by design professionals. Most read along the lines of the following:

In recognition of the relative risks and benefits of the Project to both the Client and the Design Professional, the risks have been allocated such that the Client agrees, to the fullest extent permitted by law, to limit the liability of the Design Professional and Design Professional's officers, directors, partners, employees, shareholders, owners and subconsultants for any and all claims, losses, costs, damages of any nature whatsoever whether arising from breach of contract, negligence, or other common law or statutory theory of recovery, or claims expenses from any cause or causes, including attorney's fees and costs and expert witness fees and costs, so that the total aggregate liability of the Design Professional and Design Professional's officers, directors, partners, employees, shareholders, owners and subconsultants shall not exceed \$_____, or the Design Professional's total fee for services rendered on the Project, whichever amount is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law, including but not limited to negligence, breach of contract, or any other claim whether in tort, contract or equity. If the Client does not wish to limit professional liability to this sum, if the Design Professional agrees to waive this limitation upon receiving Client's written request, and Client agrees to pay an additional consideration of _____ percent of the total fee or \$_____, whichever is greater, additional limits of liability may be made a part of this Agreement.

Practice Notes:

While these provisions are commonplace, not all U.S. jurisdictions find them enforceable. Though many states enforce them, still others hold them unenforceable unless properly worded, giving them careful scrutiny. Some states find them totally unenforceable for reasons ranging from violation of that state's anti-indemnity statutes to public policy reasons.

A vast majority of the states validating these agreements have done so in inspection contracts, alarm system agreements or other commercial transactions. Few decided opinions exist discussing these provisions in the construction contract context. Of course, the principles of law that emerge from these cases are arguably applicable to the construction industry.

[A summary table, Table 1.0, at the end of this document, compiles relevant case law and statutes on these clauses from the 50 states.]

Generally speaking, in order to contractually limit damages for a party's future negligence, the contractual language at issue must be: 1) clear, 2) unambiguous, 3) unmistakable and 4) conspicuous, in order to be enforceable. While a contractual clause limiting the amount of damages that may be recovered for the negligent acts of a party (limitation of liability clause) versus one that totally exonerates a party from its future negligent conduct (exculpatory clause) are not exactly the same, some courts categorize both such clauses as "exculpatory clauses."

An exculpatory clause is one that relieves a party from liability resulting from a negligent or wrongful act. Generally, exculpatory clauses in contracts are disfavored under the law of most states, and such contract provisions are strictly construed against the party claiming the benefit of the clause. (See eg. *Alack v. Vic Tanny Intern. of Missouri, Inc.*, 923 S.W.2d 330, 334 (Mo. 1996)). Courts are reluctant to enforce contracts that relieve parties from their future negligence. In some situations, exculpatory clauses have been held to be invalid under particular statutory provisions and in other instances because the contract is one affected with a public interest. Statutory restrictions which preclude their use hold that statutory liability for negligence cannot be contracted away.

A limitation of liability clause simply places a fixed cap on the amount of damages that may be recovered against a contracting party in the event of a claim. Generally, courts hold that such clauses are not per se against public policy, but several states are more protective, and many have enacted legislation, by way of anti-indemnity statutes that hold such clauses void and unenforceable.

Where the parties to a contract are sophisticated business entities dealing at arm's length, the limitation is reasonable in relation to the design professional's fee, and the damages are purely economic, most states will enforce a limitation of liability clause.

Enforceability of Limitation of Liability Clauses

There are several principles that emerge from those states that find limitation of liability clauses enforceable. As a rule, most states that enforce them strictly construe them against the beneficiary of the clause. The clause must still meet the above four language requirements. However, a theme from these cases is that the courts are not in a position to re-write sophisticated parties' business agreements, and will generally enforce them as written.

Some courts have held that, in the absence of evidence of separate negotiation or bargaining for the clause at issue, it will not be enforced. Some require evidence of separate consideration for the limitation of liability clause. *Schaffer v. Property Evaluations, Inc.*, 854 S.W.2d 493, 495 (Mo. App. 1993). Other courts have held that, if the clause is not conspicuous, is set out along with several other numbered paragraphs, is in the same typeface and not highlighted in any way, it is not enforceable. *Economy Forms Corporation v. J.S. Alberici Construction*, 53 S.W.3d 552 (Mo. App. 2000).

States that refuse to enforce the clauses do so for a number of reasons, including finding the clauses violative of the specific state's anti-indemnity statute, or holding that they are unenforceable as against public policy.

States Favoring the Use of Limitation of Liability Clauses

Missouri

The Missouri Supreme Court has ruled on the validity of a limitation of liability clause in *Purcell Tire and Rubber Company, Inc. v. Executive Beechcraft, Inc.*, 59 S.W.3d 505 (Mo. 2001). Purcell dealt with a limitation of liability clause in an inspection agreement between the purchaser of an aircraft and the inspection company hired to prepare an inspection report of the plane before it was purchased.

The Court noted that sophisticated commercial parties have freedom of contract, even to make a bad bargain, or to relinquish fundamental rights, such as waiving the right to a jury trial, or forum selection. The parties may also contractually limit future remedies. The Court held as a general principle that "clear, unambiguous, unmistakable, and conspicuous limitations of negligence liability do not violate public policy." If the contract effectively notifies a party that it is releasing the other party from its own future liability, sophisticated businesses that negotiate at arm's length may limit liability without specifically mentioning "negligence," "fault," or an equivalent.

Although not discussed, it is arguable the Court in Purcell would have reached a different decision in a case involving personal injury, or one involving other than economic damages.

Arkansas

Arkansas addressed the issue of limitation of liability clauses, finding them generally enforceable, in *W. William Graham, Inc. v. City of Cave City*, 709 S.W.2d 94 (Ark. 1986). In Graham, the question of the validity and enforceability of the clause was secondary in the Court's analysis, finding that it must give effect to any provision voluntarily entered into. The issue was the construction of the clause, which sought to restrict and limit recovery to damages based upon "professional negligent acts, errors, or omissions." No mention was made of liability for breach of contract, and the resultant damages that might flow from such a breach.

Though the language in the limitation of liability clause pertained to "negligent acts, errors or omissions," the jury found the defendant breached its contractual duty to perform within the time frame mutually agreed upon, entering a verdict on a contract claim and not a negligence claim. Whether the delay was occasioned by "negligence" or contract breach was not for the Court to divine, noting that, had the defendant "desired to limit its liability for breach of contract, it could have done so, and doubtless this Court would have enforced such contract proviso, as it has many times in the past." The Court noted it could not re-write the contract, indicating that such clauses are to be strictly construed against the party relying on them, limited to their exact language.

Florida

In *Florida Power & Light Co. v. Mid-Valley, Inc.*, 763 F.2d 1316 (11th Cir. 1985), the Eleventh Circuit decided whether, under Florida law, a limitation of liability clause “exculpated an engineer from damages caused by its own negligence.” The Court read the contract provision as a contract clause for indemnification under Florida law where the effect of the clause was to exculpate the indemnitee for its own negligence. A review of Florida case law and cases from other jurisdictions revealed that in order for the “indemnity contract” to be construed as allowing indemnification for the indemnitee’s own negligence, that intention must be expressed in clear and unequivocal terms.

Three variant views as to what constitutes clear and unequivocal language emerged from the Court’s analysis. A strict construction approach would not find an indemnity clause indemnifying against “any and all claims” without express reference to negligent conduct sufficiently “clear and unequivocal,” and thus unenforceable to limit a negligence claim. A more liberal approach would read the language “any and all claims” to clearly cover all types of claims, including negligence claims, and thus enforceable. A more pragmatic line of cases considers the language of the contract along with any other indications of the parties’ intentions in determining whether the intention to indemnify the indemnitee against its own negligence was the intention of the parties.

The Court held the contract satisfied Florida’s strict test applicable to cases where the indemnitee’s sole negligence caused the damage. In clear and unequivocal terms the contract specifically listed the “negligence of the Engineer” as one cause of damage that was to be the subject of the exculpatory clause and the indemnity provision. The contract also limited the Engineer’s liability for indemnity and damages by providing stated insurance coverage. It also provided a means for plaintiff to increase that insurance coverage at additional cost, which plaintiff expressly declined to do. The Court of Appeals ultimately held that under Florida law the limitation of liability clause exculpated the Engineer from its own negligence and enforced the limitation of liability clause.

States Opposing the Use of Limitation of Liability Clauses

Alaska

In *City of Dillingham v. CH2M Hill N.W., Inc.*, 873 P.2d 1271 (Al. 1994), the Alaska Supreme Court invalidated a standard limitation of liability clause, seeking to limit an engineer’s liability to the owner to \$50,000.00, or its fee, whichever was greater, for liability arising out of the engineer’s sole negligent acts, errors or omissions. The Court held the provision violative of the Alaska Anti-Indemnity Act, Alaska Statutes § 45.45.900, which prohibits as against public policy any contract that requires another to hold a party harmless from their “sole” negligence. The Court, in effect, analogized the clause as one for indemnity for those unrecovered amounts over the cap, which would result in one party indemnifying the other for their sole negligence.

New Jersey

In *Lucier v. Williams*, 366 N.J. Super. 485 (App. Div. 2004), the New Jersey Appellate Division considered the enforceability of a limitation of liability provision in a home inspection contract. Plaintiffs were first time home buyers, who contracted with an inspection company, owned by an engineer and licensed professional home inspector, to inspect a home they were purchasing. A lower court enforced a limitation of liability clause in their contract.

In determining whether to enforce the contract, the Court of Appeals looked to its adhesive nature, the subject matter of the contract, the parties' relative bargaining positions, the degree of economic compulsion motivating the adhering party, and the public interests affected by the contract. It also focused attention on whether the limitation was a reasonable allocation of risk between the parties or whether it ran afoul of the public policy disfavoring clauses which effectively immunize parties from liability for their own negligent acts.

Applying these principles to the home inspection contract in issue, the Court found the limitation of liability provision unconscionable. The Court did "not hesitate to hold it unenforceable for the following reasons: (1) the contract, prepared by the home inspector, is one of adhesion; (2) the parties, one a consumer and the other a professional expert, have grossly unequal bargaining status; and (3) the substance of the provision eviscerates the contract and its fundamental purpose because the potential damage level is so nominal that it has the practical effect of avoiding almost all responsibility for the professional's negligence. Additionally, the provision is contrary to our state's public policy of effectuating the purpose of a home inspection contract to render reliable evaluation of a home's fitness for purchase and holding professionals to certain industry standards."

Important in the Court's analysis was New Jersey statutory provisions requiring home inspectors, as a licensing prerequisite, to maintain errors and omissions insurance with a minimum coverage of \$500,000 per occurrence. *N.J.S.A.* 45:8-76a. This legislative provision provided a clear expression of public policy that home inspectors be fully liable for their errors and omissions, and to maintain "substantial insurance coverage to assure payment for any such liability."

Practical Tips for Drafting Limitation of Liability Clauses

There are certain essential elements to any limitation of liability clause. Initially, it is important that the clause is negotiated. This can be accomplished in several different ways. Use of pre-printed forms with blanks provided for filling in the appropriate liability caps (using either a standard figure, like \$50,000.00, or the professional's fee, whichever is higher, or some other limit which meaningfully takes into consideration the potential damages on the project), evidences the fact the clause was discussed. Highlighting the language in the agreement with different typeface, or bold print, or having a separate signature or initial block adjacent to the limitation of liability language will show it was conspicuous, negotiated and explicitly accepted.

Cases enforcing exculpatory clauses focus on the simple, clear and unambiguous nature of the release language at issue. Therefore, the language must specifically state that it is a release of future "negligence" or "breach of contract" in order for the clause to be an effective waiver of these claims. General language releasing future claims will not suffice to release allegations of negligence unless it is specifically mentioned.

There must also be evidence of relatively equal bargaining power during contract negotiation, not a "take it or leave it" agreement. Some courts have held that, in the absence of evidence of negotiation over the clause at issue, it will not be enforced.

Even following these suggestions does not guarantee a court will enforce the clause as written. These clauses will be subjected to case by case scrutiny. While these are simply suggestions, you should of course obtain the assistance of counsel in your respective jurisdiction to make sure that

the limitation of liability clause you are suggesting complies with the exact letter of the law in the subject state.

Sample Limitation of Liability Language

In addition to the language cited above, it is suggested the following tail language be added to any such clause to make sure the contract is not interpreted in such a way that the Court would find that the insurance or indemnity sections would conflict with, and therefore invalidate the LoL language:

Limitations on liability, waivers and indemnities in this Agreement are business understandings between the parties and shall apply to all legal theories of recovery, including breach of contract or warranty, breach of fiduciary duty, tort (including negligence), strict or statutory liability, or any other cause of action, provided that these limitations on liability, waivers and indemnities will not apply to any losses or damages that may be found by a trier of fact to have been caused by the Design Professional's gross negligence or willful misconduct. The parties also agree that the Client will not seek damages in excess of the contractually agreed-upon limitations directly or indirectly through suits against other parties who may join the Design Professional as a third-party defendant. "Parties" means the Client and the Design Professional, and their officers, directors, partners, employees, subcontractors and subconsultants.

Table 1.0

Enforceability of Limitation of Liability Clauses

Enforceability of Limitation of Liability Clauses				
State	Enforceable	Leading Case	Statute	Note
AL	Yes	Robinson v. Sovran Acquisition Limited Partnership, 70 So. 3d 390 (Ala. 2011)		
AK	No	City of Dillingham v. CH2M Hill N.W., Inc., 873 P.2d 1271 (Al. 1994)	Ak. Stat. 45.45.900	Not generally enforced and disfavored.
AZ	Yes	1800 Ocotillo, LLC v. WLB Group, Inc., 219 Ariz. 200 (Az. banc 2008)		
AR	Yes	W. William Graham, Inc. v. City of Cave City, 709 S.W.2d 94 (Ark. 1986)		They are strictly construed.
CA	Yes	Markborough California, Inc. v. Superior Court, 227 Cal. App. 3d 705 (Cal. App. 1991) <i>but compare</i> Greenwood v. Murphy,	Cal. Civil Code 2782.5	But only if found to have been “negotiated and expressly
CO	Yes	U.S. Fire Ins. Co. v. Sonitrol Management Corp., 192 P.3d 543 (Colo. App. 2008)		But not for willful or wanton conduct.
CT	Yes*	Shawmut Bank Conn. v. Connecticut Limousine Serv., Inc., 670 A.2d 880 (Conn. App. 1995)	Conn. Gen Stat. 10-290e(a) (2007)	* Per statute, not enforceable in contracts with towns or schools.
DE	Yes	J.A. Jones Constr. Co. v. City of Dover, 372 A.2d 540 (Del. Super. 1977)		
FL	Questionable	Witt v. La Gorce Country Club, Inc., 35 So.3d 1033 (Fla. Ct. App. 2010)	Fla. Stat. 725.06	Likely not in a case where there is a professional involved.
GA	Questionable	Lanier at McEver, L.P. v. Planners & Eng'rs Collaborative, Inc., 663 S.E.2d 240 (Ga. 2008), <i>and</i> Borg-Warner Ins. Finance Corp. v. Executive Park Ventures, 198 Ga. App. 70, 71, 400 S.E.2d 340 (Ga. Ct. App. 1990)	O.C.G.A. 13-8-2(b)	
HI	Yes	Leis Family Ltd. Partnership v. Silversword Engineering, 2012 WL 504184 (Hi. Ct. App. 2012), <i>and</i> City Express, Inc. v. Express Partners, 959 P.2d 836 (Hi. 1998)		
ID	Yes	Idaho State University v. Mitchell, 552 P.2d 776 (Idaho 1976)		They are strictly construed.
IL	Likely	Scott & Fetzer v. Montgomery Ward & Co., 493 N.E.2d 1022 (Ill. 1986)		They are strictly construed.
IN	Yes	Orkin Exterminating Co. v. Walters, 466 N.E.2d 55 (Ind. Ct. App. 1984)		They are strictly construed.
IA	Likely	Advance Elevator Co., Inc. v. Four State Supply Co., 572 N.W.2d 186 (Ia. Ct. App. 1997)	Iowa Code 554.2719	
KS	Yes	Santana v. Olguin, 208 P.3d 328 (Kan. App. 2009), <i>and</i> Wood River Pipeline Co. v. Willbros Energy Servs. Co., 738 P.2d		

KY	Yes	Cumberland Valley Contractors, Inc. v. Bell County Coal Corp., 238 S.W.3d 644 (Ky. 2007)		
LA	Likely	Isadore v. Interface Sec. Systems, 58 So.3d 1071 (La. App. 2011)	La. Civ. Code Ann. Art. 2004	
ME	Likely	Lloyd v. Sugarloaf Mountain Corp., 833 A.2d 1 (Maine 2003)		
MD	Likely	Adloo v. H.T. Brown Real Estate, Inc., 344 Md. 254 (Md. Ct. App. 1996)		
MA	Yes	Zavras v. Capeway Rovers Motorcycle Club, Inc. 687 N.E.2d 1263 (Mass. Ct. App. 1997)		
MI	Yes	Ohio Cas. Ins. Co. v. Oakland Plumbing Co., 2005 WL 544185 (Mi. Ct. App. 2005)		Not for willful or wanton conduct.
MN	Questionable	Yang v. Voyagaire Houseboats, Inc., 701 N.W.2d 783 (Minn. 2005)		
MS	Unlikely	Turnbough v. Ladner, 754 So. 2d 467 (Miss. 1999)	Miss. Code Ann. 31-5-41	
MO	Yes	Purcell Tire and Rubber Company, Inc. v. Executive Beechcraft, Inc., 59 S.W.3d 505 (Mo. 2001)		
MT	Unlikely	State ex rel. Mountain States Tel. & Tel. Co. v. District Court In and For Silver Bow, 160 Mont. 443 (Mont. 1972)	Mont. Code Ann. 28-2-702, 30-2-719	
NE	Yes	Ray Tucker & Sons, Inc. v. GTE Directories Sales Corp., 571 N.W.2d 64 (Neb. 1997)		
NV	Likely	Obstetrics & Gynecologists v. Pepper, 693 P.2d 1259 (Nev. 1985)		
NH	Likely	McGrath v. SNH Development, Inc., 969 A.2d 392 (N.H. 2009)	N.H. Rev. Stat. Ann. 339-A:1	Statute may prohibit contract clause that extends indemnification to design professionals.
NJ	Questionable	Stelluti v. Casapenn Enterprises, LLC, 1 A3d. 678 (N.J. 2010), Marlboro, Inc. v. Borough of Tinton Falls, 297 N.J. Super. 411 (1996)		
NM	Yes	Fort Knox Self Storage, Inc. v. Western Technologies, Inc., 142 P.3d 1 (N.M. Ct. App. 2006)		
NY	Yes	Sommer v. Federal Signal Corp., 583 N.Y.S.2d 957 (Ct. App. 1992), Long Island Lighting Co. v. Imo Deleval, Inc. 668 F. Supp 237 (S.D.N.Y. 1987)		
NC	Questionable	Schenkel & Shultz, Inc. v. Hermon F. Fox & Associates, P.C., 144 S.E.2d 393 (N.C. 2008)	N.C. Gen. Stat. 22B-1	
ND	Questionable	Reed v. Univ. of N.D., 589 N.W.2d 880 (N.D. 1999) but compare Kondrad ex rel. McPhail v. Bismarck Park Dist., 655 N.W.2d 411 (N.D. 2003)		

OH	Yes	Motorists Mut. Ins. Co. v. ADT Sec. Systems, 1995 WL 461316 (Oh. Ct. App. 1995)		Strictly construed.
OK	Likely	Elsken v. Network Multi-Family Sec. Corp., 838 P.2d 1007 (Ok. 1992)	Okla. Stat. tit. 14-421-30; tit. 15-221	
OR	Likely	Estey v. MacKenzie Eng'g Inc., 927 P.2d 86 (Or. 1996)		
PA	Yes	Chepkevich v. Hidden Valley Resort, L.P. 2 A.3d 1174 (Pa. 2010), <i>see also</i> Valhal Corp. v. Sullivan Assocs., Inc., 44 F.3d		
RI	Likely	Star-Shadow Prods., Inc. v. Super 8 Sync Sound Sys., 730 A.2d 1081 (R.I. 1999)		
SC	Yes	Georgetown Steel Corp. v. Union Carbide Corp., 806 F. Supp. 74 (D.S.C. 1992)		
SD	Likely	Rozeboom v. Northwestern Bell Telephone Co., 358 N.W.2d 241 (S.D. 1984)		
TN	Questionable*	Houghland v. Security Alarms & Services, Inc., 755 S.W.2d 769 (Tenn. 1988)	T.C.A. §62-6-123	* If public interest involved.
TX	Yes	Mickens v. Longhorn DFW Moving, Inc., 264 S.W.3d 875 (Tex. App. 2008), CBI NA-CON, Inc. v. UOP Inc., 961 S.W.2d 336 (Tex. App. 1997)	V.T.C.A., Bus. & C. §1.201	
UT	Questionable	Russ v. Woodside Homes, Inc., 905 P.2d 901 (Utah Ct. App. 1995)		
VT	Likely	Colgan v. Agway, Inc., 553 A.2d 143 (Vt. 1988), Hamelin v. Simpson Paper Co., 702 A.2d 86 (Vt. 1978)	9A V.S.A. § 2-302	
VA	Questionable	Pettit v. Chesapeake & Potomac Tel. Co. of VA 1992 WL 884663 (Va. Cir. Ct. 1992)	Va. Code Ann. 11-4.1	
WA	Likely	Markel American Ins. Co. v. Dagmar's Marina, L.L.C., 161 P.3d 1029 (Wa. Ct. App. 2007)		
WV	Likely	Arts' Flower Shop, Inc. v. Chesapeake & Potomac Telephone Co. of West Virginia, Inc., 413 S.E.2d 670 (W. Va. 1991)		
WI	Questionable	Atkins v. Swimwest Family Fitness Ctr., 691 N.W.2d 334 (Wis. 2005)	Wis. Stat. 895.447	
WY	Yes	Massengill v. S.M.A.R.T. Sports Med. Clinic, 996 P.2d 1132 (Wyo. 2000)		

Warranty, Guarantee & Certification Clauses

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Significance of the Clauses:

There are three types of clauses commonly used in most construction contracts; Warranty, Guarantee, and Certification. Each term must be examined carefully within the context it is used, as the terms may be specifically defined within the contract. More generally, the meanings of each term can vary depending on the contracting party to which it applies.

While a Warranty Clause ensures the quality of both the workmanship and the materials used during construction, a Guarantee Clause imposes a duty to return and fix things within a standardized period of time. The Certification Clause, however, provides the Owner with a real-time remedy for the General Contractor's failure to comply with the terms of the contract. Thus, The Warranty clause, Guarantee Clause and Certification Clause separately impose different obligations while concurrently providing specific rights under the construction contract. Ultimately such clauses ensure each party receives what they have contracted for - the Owner his completed project, and the General Contractor his expected profit.

A. Warranty Clause

A Warranty Clause in a construction contract expresses the General Contractor's obligation to ensure the quality of the workmanship and materials used during the construction process. A Warranty Clause such as the one cited below generally contains three separate warranties within the language of the clause, including that materials furnished for construction will be of good quality and new; the work will be free from defects not inherent in the quality required; and the work completed will conform to the requirements expressed in the contract.

Sample Warranty Clause

AIA "General Conditions" Form A-201(2007)©:

The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, material, or equipment not conforming to these requirements may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the Work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

Although the above cited Warranty Clause is typically found in the General Conditions of a construction contract, and therefore guides the overall relationship between the Owner and General Contractor, other more specific warranties may be included, such as Warranty of Legal Compliance, Survival of Warranties, and rights and obligations for any breach of a Warranty Clause.

Additionally, Warranties may be expressed or implied in a contract. One should be careful to ensure of such implied warranties during the bidding process, as courts have enforced exculpatory language to any alleged representations not contained within the written contract itself. See Oman-Fischback Int'l (JV) v. Pirie, 276 F.3d 1380, 1383-85(Fed. App. Ct. 2002). This is an important cost consideration, as the acts of third parties which are not foreseen during the construction bidding phase may eventually increase the costs, and thus decrease the revenue, to a General Contractor. See id. at 1385 (“It is, of course, settled that absent fault or negligence or an unqualified warranty on the part of its representatives, the Government is not liable for damages resulting from the action of third parties.”).

One should note the distinction between a Warranty Clause and a Certification Clause. While the former is applicable to the General Contractor, the latter is applicable to the Design Professional and often expresses the standard of care required of the Design Professional. Although both clauses make representations regarding conditions or events, a Certification Clause is often limited or otherwise qualified, and cannot arise to the level of an express warranty.

The differences noted above are separate and apart from an “Architect’s Warranty” Clause. The Certification Clause generally defines the authority a Design Professional can exercise on behalf of the owner. An Architect’s Warranty Clause is an express contractual representation by the Design Professional that he has complied with all legal requirements in performing his services.

B. Guarantee Clause

Generally, a Guarantee Clause expresses the General Contractor’s willingness to return and correct deficiencies in the completed work for a limited period of time. Thus where the Warranty Clause applies during the construction process, the Guarantee Clause becomes important to resolve disputes regarding defects in workmanship discovered after the project completion.

Sample Guarantee Clauses

AIA “General Conditions” Form A-201(1997)©:

In addition to the Contractor’s obligations under Paragraph 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under subparagraph 9.9.1, or by the term an applicable special warranty required by the Contract Documents, any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make a the correction, the Owner waives the rights to require correction by the Contractor and to make a claim

for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during the period after receipt of notice of the Owner or Architect, the Owner may correct it in accordance with Paragraph 2.4.

Additionally, the clause may provide the Owner with a right to demand that the General Contractor actually return to make such repairs. Depending on the Contract itself, the Guarantee Clause can serve several other important purposes, from shifting risks costs associated with design defects to creating a private statute of limitations on the General Contractor's obligation to return and repair design defects.

C. Certification Clause

The term "Certification Clause" can be used in a variety of situations throughout a construction contract. In its most common understanding, a Certification Clause provides the Design Professional with authority to certify that construction work generally conforms with the plans and specifications as of the date of inspection, and such work is progressing according to schedule. The Certification Clause also provides the Design Professional with authority to issue the Certificate of Completion on a project, or provides the owner with cause to withhold payment to the General Contractor.

A Design Professional may act as an independent contractor in preparing the construction plans and specifications; act as an administrator and agent of the owner by providing observations of the work progress; or as an arbitrator to resolve disputes between the owner and contractor.

Thus, under this understanding of "Certification Clause," the relationship between the Owner and Design Professional should be clearly expressed. The Design Professional's scope of duty as required by the Contract expresses those delegated duties he has as agent of the Owner, some of which are significant contractual rights which run concurrently with the Design Professional's obligations.

Sample Certification Clause

AIA "General Conditions of the Contract of Construction" - Form A201-1997(1997)©:

¶4.2.1: The Architect will provide the administration of the Contract as described in the Contract Documents, and will be the Owner's representative (1) during construction, (2) until final payments is due and (3) with the Owner's concurrence, from time to time during the one-year period for correction of Work described in Paragraph 12.2. The Architect will have authority to act on behalf of the Owner only to the extent provided in the Contract Documents, unless otherwise modified in writing in accordance with the other provision of the Contract.

¶ 4.2.3: The Architect will not be responsible for the Contractor's failure to perform the Work in accordance with the requirements of the Contract Documents. The Architect will not have control over or charge of and will not be responsible for acts or omissions of the Contractor, Subcontractors, or their agents or employees, or any other persons or entities performing portions of the Work.

A Certification Clause may also call upon the Design Professional to certify that specific building codes or third-party certifications have been met during construction. Any certification of third-party standards acts as a warranty, and is considered outside of the Design Professional's standard of care. In turn, if a Design Professional provides a warranty, his insurance coverage may be jeopardized and revoked.

D. Conclusion

Although the Warranty, Guarantee and Certification Clauses in a construction contract differ in the rights and obligation each provides, ultimately they work in concert to ensure that the obligations of each contracting party equal the other party's expectations. Thus, the Owner obligation to pay equals the General Contractor's expectation for profit and the General Contractor's Obligation to build the item equals the Owner's expectations for the item as expressed in the contract. The Design Professional may also be providing services that trigger an analysis of the various clauses. Knowing the definition of each term pursuant to the construction contract will assist in properly evaluating a particular situation.

Substantial Completion and Final Completion

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ARE WE THERE YET? More often than not in a construction project, at least one of the many players in a construction project asks the age old question: “Are we there yet?” referring of course to *Substantial Completion*. Under the AIA family of contract documents, the Consensus Docs, and basically any other contract that has any level of sophistication to it, the term “substantial completion” is used to describe a point in the project with wide legal implications. In fact, reaching (or missing) Substantial Completion is so critical to most projects, that the definition of Substantial Completion is provided for in the AIA Series of documents as its own subsection.

The current form of the A201 (2007) defines Substantial Completion as follows:

“§ 9.8.1 Substantial Completion is the stage in the progress of the Work when the Work or designated portion thereof is sufficiently complete in accordance with the Contract Documents so that the Owner can occupy or utilize the Work for its intended use.”

Taken at face value, Substantial Completion is pretty straight forward in that it reflects a point in the Project when the work is sufficiently completed such that the authorities having jurisdiction over the construction of the project would permit occupancy and use of the space by the owner. In addition, to elation of the parties, it is the time in the Project when they see the light at the end of the tunnel and for the first time it may not be a train coming at them! The practical aspects of reaching Substantial Completion have significant implications, not only in terms of turning the project over for use, but financially as well.

For instance, Substantial Completion is almost *always* the point in time when the Owner and the Contractor alike “stop the clock” on accruing any damages that they may claim on account of project delay. If the Project is behind schedule, Substantial Completion may also be the point when the Architect’s claims for Additional Services for Construction Administration may also stop. The stopping of the clock is applicable to essentially all time-related damages, including consequential damages for delay or liquidated damages, depending on what is stated in the contract. In addition, Substantial Completion is typically the time when insurance obligations for protection of the “work” transfer from the Contractor (for instance under a builder’s risk policy) to the Owner under a permanent commercial general liability or premises insurance policy. Under 9.8.4 of the A201 (2007), Substantial Completion is the time when the Owner assumes responsibility of site security, maintenance, heat, utilities, damage to the Work, and unless specific provisions are included in the contract, warranties required by the contract documents will commence.

The achievement of substantial completion *could* be the start each party’s rights under dispute resolution provisions under the contract (for instance to initiate mediation of outstanding disputes or proposed change orders), and limitations on claims (either by statute or by agreement) may also start with regard to the work in place. Under 12.2 of the AIA 201 (2007) Substantial Completion is the start of the one year period under which the Contractor may be obligated to correct any work

discovered that is defective during this one year period (which may track a one year general warranty on the work), and the milestone may also be the start date for any statute of repose for claims for latent construction defects.

In most cases, Substantial Completion is determined by the Architect upon the request of the Contractor, and with the concurrence of the Owner. Under the AIA Series of contract documents, the Architect typically issues a Certificate of Substantial Completion (AIA Document G704) which is a tri-partite agreement signed by the Architect, Contractor and Owner. Often the Certificate of Substantial Completion is accompanied by the list of known punchlist items, which when acknowledged by all parties, greatly reduces the likelihood of continuing disputes on what work still needs to be accomplished to the satisfaction of the Owner and Architect in order for the Contractor to reach Final Completion. Incorporation of all known punchlist items or issues that need to be completed or reworked permits the parties to each understand and acknowledge their outstanding obligations prior to reaching final completion of the project, and it allows the parties to establish an agreed upon schedule and time frame for completing the outstanding work.

In addition to documenting outstanding work items, incorporating the punchlist into the Certificate of Substantial Completion allows the parties to adjust the amount of retainage being held against the Contract amount. With the punchlist in hand, Architect makes a determination of the value of the work left to be completed so that the Owner can withhold the appropriate amounts to complete the project in the event the Contractor fails to do so. In light of this purpose for issuing a Certificate of Substantial Completion, the role of the Architect in certifying Substantial Completion should not be taken lightly so that the Owner is not put in a position of financial risk to complete the project.

After Substantial Completion is achieved, the parties turn their collective attentions to Final Completion. How vigorously, and cohesively, the parties work towards Final Completion will vary from project to project, and party to party, because the factors controlling this period between Substantial Completion and the “end” of the Project can vary widely. For example, if the punchlist is small and the Owner’s goal is to take over the space and not be interrupted by the Contractor’s forces finishing the items on the punchlist, the period between Substantial Completion and Final Completion may be drawn out. Other factors that influence how long Final Completion takes includes the financial condition of the Owner (i.e. are they in a position that disbursing all remaining retention is not immediately practical or possible), or is the punchlist so extensive that completing it to the satisfaction of the Owner and the Architect is no small feat. The mood of the Project also impacts how long Final Completion may take. For example, if the Architect has fully exhausted the entire Construction Administration budget dealing with claims, or responding to extensive requests for additional project information, then the Architect may be less proactive to help, or less willing to expend additional resources, to see the project through to the end. On the other side of the coin, the Contractor and its forces may be focused on the next project, meaning that this Project is in the rearview mirror.

Whatever factors may exist, under the AIA series of documents Final Completion is the time when all of the work under the Contract has been fully performed, and all project close-out documentation has been received by the Architect and Owner. See e.g. §9.10 of the AIA A201 (2007). The typical project documentation includes written warranties, operation and maintenance (O&M) manuals and documentation, certified payrolls and final lien waivers (when required), and other documents that the parties’ have determined are required under the Contract. Aside from the Architect’s certification of Final Completion, the Architect is often required to provide certain

“certificates” to the Owner and/or its lender(s) that certify (within the bounds of the appropriate standard of care) that the Project as constructed conforms to the Contract Documents, applicable codes and regulations, and zoning requirements. The Architect's Final Certificate for Payment will constitute the Architect's acknowledgement that all conditions necessary to issuing the final payment to the Contractor have been satisfied, and that the Work is ready to be accepted as completed by the Owner. Assuming there are no outstanding disputes, the issuance of the Final Certificate for Payment is the proverbial finish line for the Project.

Contract Termination

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Life is good at the beginning of every new construction project. Owners anticipate the project finishing on time and under budget and contractors expect timely payments and a healthy profit at the end of the day. Unfortunately, the parties' expectations are often shattered at some point in the project and one party is confronted with the unpleasant dilemma of terminating the contract. Contract termination occurs when one party ends a contract before it has been fully performed. Termination can occur by mutual agreement of the parties or one party's exercise of a contractual right to terminate the contract. In the construction industry, contract termination usually takes one of two forms, termination for convenience or termination for cause. Regardless of how it occurs, it is important to understand your contract's termination provisions to determine (1) what conditions (if any) must be satisfied before a contract can be terminated, (2) what your rights are if a contract is terminated, and (3) what steps, if any, you must take to preserve a claim for compensation.

Termination for Convenience:

A termination for convenience clause generally allows an owner to terminate a contract regardless of whether the contractor or owner has fulfilled its obligations under the agreement. It generally provides a no-fault process for terminating the contract for the convenience of the owner.

Upon receipt of a notice of termination for convenience, a contractor must generally stop all work, cancel orders for materials, and take steps necessary to preserve the project. Contracts will generally define what remedies, if any, are available to a contractor after a termination for convenience. A contractor can generally recover the cost of the work performed prior to termination, termination costs for subcontracts already entered into, demobilization, and other incidental costs associated with stopping work on the project. Depending on the contract, a contractor may also be able to recover reasonable overhead and profit on the work not performed or some other defined percentage that the parties agree to and include in the contract.

Sample Termination for Convenience Clauses:

AIA A201 General Conditions of the Contract (2007)

§ 14.4.1 The Owner may, at any time, terminate the Contract for the Owner's convenience and without cause.

§ 14.4.2 Upon receipt of written notice from the Owner of such termination for the Owner's convenience, the Contractor shall

1. cease operations as directed by the Owner in the notice;

2. take actions necessary, or that the Owner may direct, for the protection and preservation of the Work; and
3. except for Work directed to be performed prior to the effective date of termination stated in the notice, terminate all existing subcontracts and purchase orders and enter into no further subcontracts and purchase orders.

§ 14.4.3 In case of such termination for the Owner's convenience, the Contractor shall be entitled to receive payment for Work executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.

Engineer Joint Contract Document Committee - Standard General Conditions of the Construction Contract (C-700), Article 15.03 (2007)

- A. Upon seven days written notice to Contractor and Engineer, Owner may, without cause and without prejudice to any other right or remedy of Owner, terminate the Contract. In such case, Contractor shall be paid for (without duplication of any items):
1. completed and acceptable Work executed in accordance with the Contract Documents prior to the effective date of termination, including fair and reasonable sums for overhead and profit on such Work;
 2. expenses sustained prior to the effective date of termination in performing services and furnishing labor, materials, or equipment as required by the Contract Documents in connection with uncompleted Work, plus fair and reasonable sums for overhead and profit on such expenses;
 3. all claims, costs, losses, and damages (including but not limited to all fees and charges of engineers, architects, attorneys, and other professionals and all court or arbitration or other dispute resolution costs) incurred in settlement of terminated contracts with Subcontractors, Suppliers, and others; and
 4. reasonable expenses directly attributable to termination.
- B. Contractor shall not be paid on account of loss of anticipated profits or revenue or other economic loss arising out of or resulting from such termination.

Termination for Cause (Default):

Most commercial construction contracts also include provisions allowing either party to terminate a contract for cause (also referred to as a termination for "default"). Unlike terminations for convenience, contracts generally define the specific events that will allow an owner or contractor to terminate a contract for cause.

From the owner's perspective, "cause" is generally defined as a contractor's persistent failure to perform the work in accordance with the contract documents, failure of a contractor to pay its subcontractors after receiving payment from the owner, disregard of laws or regulations, or disregard of the owner's authorized representative. Contracts will generally require that the owner

provide advanced notice (usually 7 days) to the contractor, and may or may not give the contractor an opportunity to correct the issue before the owner can terminate. If the owner terminates for cause, the owner can generally exclude the contractor from the work site, take possession of the contractor's material and equipment on site, take over existing subcontracts, and finish the work on its own. After the project is completed, an owner is typically required to refund the difference (if any) between the cost incurred to complete the project and the amount of contract funds remaining when the contract was terminated. If the completion cost exceeds the amount of remaining contract funds, the owner can generally recover the excess costs incurred to complete the contract from the contractor.

Many construction contracts also give contractors the right to terminate an agreement for cause. Contracts typically allow a contractor to terminate for cause if the owner fails to pay the contractor in accordance with the contract, the project is suspended or delayed for a substantial amount of time (typically 30 to 60 days) through no act or fault of the contractor, or the owner fails to provide adequate assurances that they have the financial resources to finish the project. Contractors, like owners, are generally required to provide advance notice of their intent to terminate, and the contract may give the owner an opportunity to cure before the contract can be terminated. If the contract is terminated, a contractor can generally recover payment for the work performed, including reasonable overhead, profit and any damages (e.g., demobilization). Depending on the contract and local law, contractors may also be able to recover lost profit on work not performed.

Sample Termination for Cause Clauses:

Termination by the Owner for Cause:

AIA A201 General Conditions of the Contract (2007)

§ 14.2.1 The Owner may terminate the Contract if the Contractor

1. repeatedly refuses or fails to supply enough properly skilled workers or proper materials;
2. fails to make payment to Subcontractors for materials or labor in accordance with the respective agreements between the Contractor and the Subcontractors;
3. repeatedly disregards applicable laws, statutes, ordinances, codes, rules and regulations, or lawful orders of a public authority; or
4. otherwise is guilty of substantial breach of a provision of the Contract Documents.

§ 14.2.2 When any of the above reasons exist, the Owner, upon certification by the Initial Decision Maker that sufficient cause exists to justify such action, may without prejudice to any other rights or remedies of the Owner and after giving the Contractor and the Contractor's surety, if any, seven days' written notice, terminate employment of the Contractor and may, subject to any prior rights of the surety:

1. Exclude the Contractor from the site and take possession of all materials, equipment, tools, and construction equipment and machinery thereon owned by the Contractor;
2. Accept assignment of subcontracts pursuant to Section 5.4; and
3. Finish the Work by whatever reasonable method the Owner may deem expedient. Upon written request of the Contractor, the Owner shall furnish to the Contractor a detailed accounting of the costs incurred by the Owner in finishing the Work.

§ 14.2.3 When the Owner terminates the Contract for one of the reasons stated in Section 14.2.1, the Contractor shall not be entitled to receive further payment until the Work is finished.

§ 14.2.4 If the unpaid balance of the Contract Sum exceeds costs of finishing the Work, including compensation for the Architect's services and expenses made necessary thereby, and other damages incurred by the Owner and not expressly waived, such excess shall be paid to the Contractor. If such costs and damages exceed the unpaid balance, the Contractor shall pay the difference to the Owner. The amount to be paid to the Contractor or Owner, as the case may be, shall be certified by the Initial Decision Maker, upon application, and this obligation for payment shall survive termination of the Contract.

Engineer Joint Contract Document Committee - Standard General Conditions of the Construction Contract (C-700), Article 15.02 (2007)

A. The occurrence of any one or more of the following events will justify termination for cause:

1. Contractor's persistent failure to perform the Work in accordance with the Contract Documents (including, but not limited to, failure to supply sufficient skilled workers or suitable materials or equipment or failure to adhere to the Progress Schedule established under Paragraph 2.07 as adjusted from time to time pursuant to Paragraph 6.04);
2. Contractor's disregard of Laws or Regulations of any public body having jurisdiction;
3. Contractor's repeated disregard of the authority of Engineer; or
4. Contractor's violation in any substantial way of any provisions of the Contract Documents.

B. If one or more of the events identified in Paragraph 15.02.A occur, Owner may, after giving Contractor (and surety) seven days written notice of its intent to terminate the services of Contractor:

1. exclude Contractor from the Site, and take possession of the Work and of all Contractor's tools, appliances, construction equipment, and machinery at the

Site, and use the same to the full extent they could be used by Contractor (without liability to Contractor for trespass or conversion);

2. incorporate in the Work all materials and equipment stored at the Site or for which Owner has paid Contractor but which are stored elsewhere; and
3. complete the Work as Owner may deem expedient.

- C. If Owner proceeds as provided in Paragraph 15.02.B, Contractor shall not be entitled to receive any further payment until the Work is completed. If the unpaid balance of the Contract Price exceeds all claims, costs, losses, and damages (including but not limited to all fees and charges of engineers, architects, attorneys, and other professionals and all court or arbitration or other dispute resolution costs) sustained by Owner arising out of or relating to completing the Work, such excess will be paid to Contractor. If such claims, costs, losses, and damages exceed such unpaid balance, Contractor shall pay the difference to Owner. Such claims, costs, losses, and damages incurred by Owner will be reviewed by Engineer as to their reasonableness and, when so approved by Engineer, incorporated in a Change Order. When exercising any rights or remedies under this Paragraph, Owner shall not be required to obtain the lowest price for the Work performed.
- D. Notwithstanding Paragraphs 15.02.B and 15.02.C, Contractor's services will not be terminated if Contractor begins within seven days of receipt of notice of intent to terminate to correct its failure to perform and proceeds diligently to cure such failure within no more than 30 days of receipt of said notice.
- E. Where Contractor's services have been so terminated by Owner, the termination will not affect any rights or remedies of Owner against Contractor then existing or which may thereafter accrue. Any retention or payment of moneys due Contractor by Owner will not release Contractor from liability.
- F. If and to the extent that Contractor has provided a performance bond under the provisions of Paragraph 5.01.A, the termination procedures of that bond shall supersede the provisions of Paragraphs 15.02.B and 15.02.C.

Termination by the Contractor for Cause:

AIA A201 General Conditions of the Contract (2007)

§ 14.1.1 The Contractor may terminate the Contract if the Work is stopped for a period of 30 consecutive days through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, for any of the following reasons:

1. Issuance of an order of a court or other public authority having jurisdiction that requires all Work to be stopped;
2. An act of government, such as a declaration of national emergency that requires all Work to be stopped;

3. Because the Architect has not issued a Certificate for Payment and has not notified the Contractor of the reason for withholding certification as provided in Section 9.4.1, or because the Owner has not made payment on a Certificate for Payment within the time stated in the Contract Documents; or
4. The Owner has failed to furnish to the Contractor promptly, upon the Contractor's request, reasonable evidence as required by Section 2.2.1.

§ 14.1.2 The Contractor may terminate the Contract if, through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, repeated suspensions, delays or interruptions of the entire Work by the Owner as described in Section 14.3 constitute in the aggregate more than 100 percent of the total number of days scheduled for completion, or 120 days in any 365-day period, whichever is less.

§ 14.1.3 If one of the reasons described in Section 14.1.1 or 14.1.2 exists, the Contractor may, upon seven days' written notice to the Owner and Architect, terminate the Contract and recover from the Owner payment for Work executed, including reasonable overhead and profit, costs incurred by reason of such termination, and damages.

§ 14.1.4 If the Work is stopped for a period of 60 consecutive days through no act or fault of the Contractor or a Subcontractor or their agents or employees or any other persons performing portions of the Work under contract with the Contractor because the Owner has repeatedly failed to fulfill the Owner's obligations under the Contract Documents with respect to matters important to the progress of the Work, the Contractor may, upon seven additional days' written notice to the Owner and the Architect, terminate the Contract and recover from the Owner as provided in Section 14.1.3.

Engineer Joint Contract Document Committee - Standard General Conditions of the Construction Contract (C-700), Article 15.04(2007)

- A. If, through no act or fault of Contractor, (i) the Work is suspended for more than 90 consecutive days by Owner or under an order of court or other public authority, or (ii) Engineer fails to act on any Application for Payment within 30 days after it is submitted, or (iii) Owner fails for 30 days to pay Contractor any sum finally determined to be due, then Contractor may, upon seven days written notice to Owner and Engineer, and provided Owner or Engineer do not remedy such suspension or failure within that time, terminate the Contract and recover from Owner payment on the same terms as provided in Paragraph 15.03.
- B. In lieu of terminating the Contract and without prejudice to any other right or remedy, if Engineer has failed to act on an Application for Payment within 30 days after it is submitted, or Owner has failed for 30 days to pay Contractor any sum finally determined to be due, Contractor may, seven days after written notice to Owner and Engineer, stop the Work until payment is made of all such amounts due Contractor, including interest thereon. The provisions of this Paragraph 15.04 are not intended to preclude Contractor from making a Claim under Paragraph 10.05 for an adjustment in Contract Price or Contract Times or

otherwise for expenses or damage directly attributable to Contractor's stopping the Work as permitted by this Paragraph.

Conclusion:

Contract termination is generally an unpleasant, yet sometimes unavoidable, prospect for all of the parties involved. Regardless of the manner in which contract termination occurs, parties must comply with contractual termination provisions, and if terminating for cause, carefully analyze the facts to determine if the termination is justified. The consequences of a wrongful termination can be severe. Where an owner wrongfully terminates a party who did not breach the contract, they could be held liable for a material breach of the contract which may enable the contractor to recover damages for lost profits and other costs incurred in partially performing the work. Likewise, contractors who wrongfully terminate could potentially be liable for not only the costs incurred by the owner in hiring a replacement contractor, but also significant consequential damages.

After a contract is terminated, contractors should quickly evaluate whether they need to take any action to preserve lien rights, or in the case of subcontractors, claims against payment bonds. Further, contractors need to immediately review their contract to determine what, if any, rights the owner may have to take possession of materials and equipment and develop a plan to mitigate the impact of the termination on the contractor, subcontractors, and the owner. In situations where a contractor has provided a performance bond, owners should also carefully review the terms of the bond and take all steps required (eg., notice to surety) to preserve a claim on the bond.

Contract termination is a drastic measure that should not be taken lightly. To avoid the situation, or at least mitigate its impact, there are several practical steps that parties can take.

Parties may be able to avoid problems in the future by carefully drafting the contract's termination provisions. For example, parties are free to define what events will allow a party to terminate the contract and reduce the risks associated with wrongful termination.

Termination, like all disputes, can also be avoided by early and deliberate communication. As soon as a problem emerges, a party should alert the other side to the issue so that it can be quickly resolved. Often, problems that eventually lead to contract termination could have been solved very easily if the parties had devoted the necessary time and attention to it earlier in a project.

Because of the severe consequences of wrongful termination, parties must carefully consider their contractual rights, as well as alternative courses of action, before moving forward. In some situations, contract termination may be the proper course of action, but the decision to do so should only be made after careful deliberation.

Indemnity, Insurance and Additional Insureds

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Significance of these Clauses

The primary risk shifting devices in any construction contract are its indemnification and insurance provisions. These provisions attempt to allocate anticipated risks to those who should more appropriately bear responsibility based on the duties assumed under the parties' respective contracts. Indemnification clauses require one party to pay the legal and other expenses of another party. Contractual insurance provisions work hand-in-hand with indemnification clauses to place responsibility for insuring risks of the project on down-stream parties. Oftentimes, contractual insurance provisions result in down-stream parties providing indemnity to up-stream parties by mandating broad-form insurance coverage akin to an indemnity clause. In most states, the enforceability of indemnity provisions are governed by statute, with many states prohibiting wide reaching indemnity provisions that shift complete responsibility to other parties who are without fault or are only partially at fault.

[Because of the wide reaching and serious financial consequences indemnity and insurance provisions pose, it is strongly recommended that these provisions be reviewed by an attorney in the applicable jurisdiction who is familiar with construction contracts, as well as an insurance professional, like a broker or underwriter.]

Indemnity

Sample Clauses

The 2007 versions of the standard AIA form documents contain indemnity language, an example of which is found in AIA Document A201 (2007), "General Conditions of the Contract for Construction," §3.18, INDEMNIFICATION, which provides as follows:

§ 3.18.1 To the fullest extent permitted by law the Contractor shall indemnify and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge, or reduce other

rights or obligations of indemnity that would otherwise exist as to a party or person described in this Section 3.18.

§ 3.18.2 In claims against any person or entity indemnified under this Section 3.18 by an employee of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, the indemnification obligation under Section 3.18.1 shall not be limited by a limitation on amount or type of damages, compensation or benefits payable by or for the Contractor or a Subcontractor under workers' compensation acts, disability benefit acts or other employee benefit acts.

The current versions of the ConsensusDOCS also contain indemnity provisions, specifically like those found in ConsensusDOCS 200, "Standard Agreement and General Conditions Between Owner and Constructor," Article 10, INDEMNITY, INSURANCE AND BONDS, which state as follows:

10.1 INDEMNITY

10.1.1 To the fullest extent permitted by law, the Constructor shall indemnify and hold harmless the Owner, the Owner's officers, directors, members, consultants, agents and employees, the Design Professional, and Others (the Indemnitees) from all claims for bodily injury and property damage, other than to the Work itself and other property insured, including reasonable attorney's fees, costs and expenses, that may arise from the performance of the work, but only to the extent caused by the negligent acts or omissions of the Constructor, Subcontractors or anyone employed directly or indirectly by any of them or by anyone for whose acts any of them may be liable. The Constructor shall be entitled to reimbursement of any defense costs paid above the Constructor's percentage of liability for the underlying claim to the extent provided for by the subsection below.

10.1.2 To the fullest extent permitted by law, the Owner shall indemnify and hold harmless the Constructor, its officers, directors, members, consultants, agents, and employees, Subcontractors or anyone employed directly or indirectly by any of them or anyone for whose acts any of them may be liable from all claims for bodily injury and property damage, other than property insured, including reasonable attorney's fees, costs and expenses, that may arise from the performance of work by the Owner, the Design Professional, or Others, but only to the extent caused by the negligent acts or omissions of the Owner, the Design Professional, or Others. The Owner shall be entitled to reimbursement of any defense costs paid above the Owner's percentage of liability for the underlying claim to the extent provided for by the subsection above.

10.1.3 NO LIMITATION ON LIABILITY In any and all claims against the Indemnitees by any employee of the Constructor, anyone directly or indirectly employed by the Constructor or anyone for whose acts the Constructor may be liable, the indemnification obligation shall not be limited in any way by any limitation on the amount or type of damages, compensation or benefits payable by or for the Constructor under workers' compensation acts, disability benefit acts or other employment benefit acts.

The ConsensusDOCS' indemnity provisions are significantly different from the provisions in the AIA A201. Initially, the Consensus DOCS language appears to be more along the lines of a limited form indemnity agreement, while the AIA reads more like an intermediate form indemnity clause. (These terms and their scope are discussed below). Further, the ConsensusDOCS have a "mutual" indemnity provision. Additionally, the ConsensusDOCS indemnity provisions allow either party to recover their defense costs to the extent they exceed their respectively apportioned percentages of liability. It could be difficult to reach agreement on the percentage of each party's fault if the matter is settled outside of a trial.

Practice Notes

Indemnification is an equitable doctrine that shifts the burden of a judgment from one party to another. The indemnitor is the party holding the other party harmless, the indemnitee. Indemnification is different from contribution, which apportions liability among a number of jointly liable parties who share common liability to an injured party. Therefore, while contribution distributes the loss among parties, each bearing its own pro-rata share, indemnification transfers the entire loss from one party to another.

The common law (case law) of most states impose limitations on the enforceability of certain risk transfers, like indemnity agreements. Courts will only enforce these agreements if they are convinced it will achieve the result intended by the parties, and the language in question is clear, unequivocal, and accepted by both parties. When interpreting indemnification language, courts employ a stringent standard, requiring express use of words like "negligence," conspicuous location in the contract, and other "fair notice requirements."

In addition to this common law scrutiny, because of the significance of these agreements in the construction context, most states enacted statutes that limit or prohibit certain indemnification agreements. A summary table of these statutes and their significance is attached to this article as Table 2.0.

Broad, Intermediate, and Limited Form Indemnity

Indemnity provisions span a continuum, but typically fall into one of three categories; broad, intermediate, and limited form. Generally, the different forms of indemnity are characterized as follows:

Broad Form:

Under this form, the indemnitor assumes an unqualified obligation to hold harmless the indemnitee for all liability, regardless of fault. Even if the indemnitee is solely at fault, the indemnitor still has the obligation to indemnify. The obligation to indemnify the other party is triggered if the indemnitor is at all responsible for a claim (technically only 1%), but also includes the obligation to indemnify even if the indemnitee is solely negligent. These clauses effectively shift the entire risk of loss from one party to the other, and are generally prohibited by most states.

Intermediate Form:

Under this form, the indemnitor assumes an obligation to hold harmless the indemnitee for all liability, unless the indemnitee is 100% at fault. Any amount of fault on the part of the indemnitee obligates them to cover the entire loss. The obligation to indemnify the other party is triggered if the indemnitor is at all responsible for a claim (technically only 1%), however, includes the exception that the obligation to indemnify does not apply if the indemnitee is solely negligent. The language of the AIA A201 appears to follow this form of indemnity provision.

Limited Form:

Under this form, parties to the agreement are only responsible for indemnity to the extent of their own liability, on a comparative basis of fault. The obligation to indemnify the other party only extends to the extent of the indemnitor's negligence. The ConsensusDOCS 200 language appears to follow this form of agreement.

The three different forms typically use the following language:

Broad Form:

"Shall indemnify for claims arising out of...whether caused in whole or in part by the negligence of the Indemnitee...It is specifically understood that this indemnity shall be interpreted as indemnifying the Indemnitee from its own sole and/or partial negligence."

Intermediate Form:

"Shall indemnify...whether caused in part by the negligence of the Indemnitee...This clause is not intended to indemnify the Indemnitee for claims, damages, losses and expenses caused by the sole negligence of the Indemnitee."

Limited Form:

"Shall indemnify...but only to the extent caused in whole or in part by the negligent acts or omissions of Indemnitor...under a comparative basis of fault."

Depending on the state, some of these forms of contractual indemnity are unenforceable. See Table 2.0 for the various statutes governing these clauses and whether they are enforceable.

Waiver of the Exclusivity of Workers' Compensation

See: AIA Document A201, §3.18.2
ConsensusDOCS 200, Article 10.1.3

Some states limit the liability of a party whose employee is injured to the amount of workers' compensation benefits. As a result, a contractor who is primarily at fault for its employee's injury may escape liability except for the small cost of workers' compensation payments. This forces injured parties to look to up-stream parties when they file personal injury actions. When they do, the up-stream party may be prohibited from seeking indemnity from the party actually responsible for the claim. Certain contractual provisions constitute a waiver of that limitation, and allow up-stream parties the opportunity to bring the responsible employer back into the action, fully exposed to the loss.

In some states,¹ up-stream contractors are immune from this liability in tort for injuries sustained by the employee of a subcontractor under the exclusivity provision of that state's workers' compensation act, even though the contractor was not technically the "employer" of the injured employee. In these states, the general contractor is considered a "statutory employer" under the workers' compensation act and the exclusive remedy for the subcontractor's employee is to recover under the framework of the act. There are exceptions, including inherently dangerous activity, when the contractor maintains control over the manner and method of work (such as a non-delegable duty), or a claim for negligent hiring or selection of the subcontractor.

However, most other states allow these "action over claims," which can oftentimes result in a third party claim against the subcontractor/employer, if the subcontractor/employer has waived certain defenses in its contract. One state allowing these kinds of claims is Illinois, which allows a third party action against the injured employee's employer by the general contractor or owner. See Kotecki v. Cyclops Welding Corp., 585 N.E.2d 1023 (Ill. 1991). These clauses require the employer to waive the exclusivity defense of workers' compensation to the action by the upstream party, potentially exposing them to unlimited damages. Since it is only a waiver of an affirmative defense to the action, and not the assumption of additional tort liability, these clauses are generally not prohibited by most states' anti-indemnity statutes.

Insurance and Additional Insureds

While indemnity and other risk shifting devices are essential construction contract fare, they are only as effective as the indemnitor's financial ability to meet its obligation to the indemnitee. Contractually required insurance potentially provides a way to back-up the indemnity provisions discussed above. The point of insurance provisions is to further protect up-stream parties from claims that may arise as a result of the work of down-stream parties, through negligence or vicarious liability claims.

Standard Insurance Services Office, Inc. (ISO) CGL coverage form policies automatically provide coverage for "insured contracts," which includes construction contracts containing indemnity provisions. Coverage under these provisions is commonly referred to as "contractual liability coverage," which is a part of the broad coverage generally defined by the CGL's insuring agreement.

¹ Florida, Georgia, Idaho, Kentucky, Maryland, South Carolina, Tennessee, Vermont, and Virginia.

Sample Clauses

The 2007 versions of the standard AIA form documents contain detailed insurance provisions, found in AIA Document A201 (2007), “General Conditions of the Contract for Construction,” §11 INSURANCE AND BONDS, which provides as follows:

ARTICLE 11 INSURANCE AND BONDS

§ 11.1 CONTRACTOR’S LIABILITY INSURANCE

§ 11.1.1 The Contractor shall purchase from and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor’s operations and completed operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable:

1. Claims under workers’ compensation, disability benefit and other similar employee benefit acts that are applicable to the Work to be performed;
2. Claims for damages because of bodily injury, occupational sickness or disease, or death of the Contractor’s employees;
3. Claims for damages because of bodily injury, sickness or disease, or death of any person other than the Contractor’s employees;
4. Claims for damages insured by usual personal injury liability coverage;
5. Claims for damages, other than to the Work itself, because of injury to or destruction of tangible property, including loss of use resulting therefrom;
6. Claims for damages because of bodily injury, death of a person or property damage arising out of ownership, maintenance or use of a motor vehicle;
7. Claims for bodily injury or property damage arising out of completed operations; and
8. Claims involving contractual liability insurance applicable to the Contractor’s obligations under Section 3.18.

§ 11.1.2 The insurance required by Section 11.1.1 shall be written for not less than limits of liability specified in the Contract Documents or required by law, whichever coverage is greater. Coverages

shall be written on an occurrence basis and shall be maintained without interruption from the date of commencement of the Work until the date of final payment and termination of any coverage required to be maintained after final payment, and, with respect to the Contractor's completed operations coverage, until the expiration of the period for correction of Work or for such other period for maintenance of completed operations coverage as specified in the Contract Documents.

§ 11.1.3 Certificates of insurance acceptable to the Owner shall be filed with the Owner prior to commencement of the Work and thereafter upon renewal or replacement of each required policy of insurance. These certificates and the insurance policies required by this Section 11.1 shall contain a provision that coverages afforded under the policies will not be modified, canceled or allowed to expire until at least 30 days' prior written notice has been given to the Owner. An additional certificate evidencing continuation of liability coverage, including coverage for completed operations, shall be submitted with the final Application for Payment as required by Section 9.10.2 and thereafter upon renewal or replacement of such coverage until the expiration of the time required by Section 11.1.2. Information concerning reduction of coverage on account of revised limits or claims paid under the General Aggregate, or both, shall be furnished by the Contractor with reasonable promptness.

§ 11.1.4 The Contractor shall cause the commercial liability coverage required by the Contract Documents to include (1) the Owner, the Owner's lender(s), the Owner's landlord, the Architect and the Architect's Consultants as additional insureds for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's operations; and (2) the Owner as an additional insured for claims caused in whole or in part by the Contractor's negligent acts or omissions during the Contractor's completed operations.

§ 11.3.7 WAIVERS OF SUBROGATION

The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Section 11.3 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

The current versions of the ConsensusDOCS also contain detailed insurance requirements, found in ConsensusDOCS 200, "Standard Agreement and General Conditions Between Owner and Constructor," Article 10, INDEMNITY, INSURANCE AND BONDS, which state as follows:

10.2.1 Before commencing the Work and as a condition precedent to payment, the Constructor shall procure and maintain in force Workers' Compensation Insurance, Employers' Liability Insurance, Business Automobile Liability Insurance, and Commercial General Liability Insurance (CGL). The CGL policy shall include coverage for liability arising from premises, operations, independent contractors, products-completed operations, personal injury and advertising injury, contractual liability, and broad form property damage. The Constructor's Employers' Liability, Business Automobile Liability, and CGL policies shall be written with at least the following limits of liability:

* * *

10.2.2 Employers' Liability, Business Automobile Liability and CGL coverage required under subsection 10.2.1 may be arranged under a single policy for the full limits required or by a combination of underlying policies with the balance provided by Excess or Umbrella Liability policies.

10.2.3 The Constructor shall maintain in effect all insurance coverage required under subsection 10.2.1 with insurance companies lawfully authorized to do business in the jurisdiction in which the Project is located. If the Constructor fails to obtain or maintain any insurance coverage required under this Agreement, the Owner may purchase such coverage and charge the expense to the Constructor, or terminate this Agreement.

10.2.4 The policies of insurance required under subsection 10.2.1 shall contain a provision that the coverage afforded under the policies shall not be cancelled or allowed to expire until at least thirty (30) Days' prior written notice has been given to the Owner. The Constructor shall maintain completed operations liability insurance for one year after acceptance of the Work, Substantial Completion of the Project, or to the time required by the Contract Documents, whichever is longer. Before commencing the Work, the Constructor shall furnish the Owner with certificates evidencing the required coverage.

10.3 PROPERTY INSURANCE

10.3.3 The Owner and the Constructor waive all rights against each other and their respective employees, agents, contractors, subcontractors and sub-subcontractors, and design professionals for damages caused by risks covered by the property insurance except such rights as they may have to the proceeds of the insurance and such rights as the Constructor may have for the failure of the Owner to obtain and maintain property insurance in compliance with subsection 10.3.1.

10.3.4 To the extent of the limits of the Constructor's CGL specified in subsection 10.2.1 or [_____] dollars (\$[_____]_____), whichever is more, the Constructor shall indemnify and hold harmless the Owner against any and all liability, claims, demands, damages, losses and expenses, including attorneys' fees, in connection with or arising out of any damage or alleged damage to any of the Owner's existing adjacent property that may arise from the performance of the Work, to the extent caused by the negligent acts or omissions of the Constructor, Subcontractor, or anyone employed directly or indirectly by any of them or by anyone for whose acts any of them may be liable.

10.3.5 RISK OF LOSS Except to the extent a loss is covered by applicable insurance, risk of loss or damage to the Work shall be upon the Constructor until the Date of Substantial Completion, unless otherwise agreed to by the Parties.

10.4 OWNER'S INSURANCE

10.4.1 BUSINESS INCOME INSURANCE The Owner may procure and maintain insurance against loss of use of the Owner's property caused by fire or other casualty loss.

10.4.2 OWNER'S LIABILITY INSURANCE The Owner shall either self-insure or obtain and maintain its own liability insurance for protection against claims arising out of the performance of this Agreement, including without limitation, loss of use and claims, losses, and expenses arising out of the Owner's acts or omissions.

10.5 ADDITIONAL GENERAL LIABILITY COVERAGE

10.5.1 The Owner [] shall/[] shall not (indicate one) require the Constructor to purchase and maintain additional liability coverage, primary to the Owner's coverage under subsection 10.4.2.

10.5.2 If required by the above subsection, the additional liability coverage required of the Constructor shall be

1. Additional Insured. The Owner shall be named as an additional insured on the Constructor's CGL specified for operations and completed operations, but only with respect to liability for bodily injury, property damage or personal and advertising injury to the extent caused by the negligent acts or omissions of the Constructor, or those acting on the Constructor's behalf, in the performance of the Constructor's Work for the Owner at the Worksite.
2. OCP. The Constructor shall provide an Owners' and Contractors' Protective Liability Insurance ("OCP") policy with limits equal to the limits on CGL specified, or limits as otherwise required by the Owner.

Any documented additional cost in the form of a surcharge associated with procuring the additional general liability coverage in accordance with this subsection shall be paid by the Owner directly or the costs may be reimbursed by the Owner to the Constructor by increasing the Contract Price to correspond to the actual cost required to purchase and maintain the coverage. Before commencing the Work, the Constructor shall provide either a copy of the OCP policy, or a certificate and endorsement evidencing that the Owner has been named as an additional insured, as applicable.

The AIA's additional insurance provisions under the A201 require the contractor to provide CGL coverage identifying: 1) the owner, architect and the architect's consultants as additional insureds for claims caused in whole or part by the contractor's negligent acts or omissions during the contractor's operations; and 2) the owner as an additional insured for claims caused in whole or part by the contractor's negligent acts or omissions during the contractor's completed operations. It also requires completed operations coverage until the expiration of the period for correction of work or for such other period for maintenance of completed operations as specified in the contract documents.

Significantly different, under the ConsensusDOCS, there is no default duty to provide any additional insurance coverage to any party. Instead, the parties elect whether the contractor will be required to provide additional insurance coverage by checking designated boxes. If the parties elect to require the contractor to provide additional insurance coverage, the owner is responsible for paying any additional costs incurred in obtaining the coverage. The ConsensusDOCS require completed operations coverage to be provided for at least one year after acceptance of the work, substantial completion of the project, or as required under the contract documents.

Practice Notes

One of the most commonly used methods of risk shifting in construction projects is through insurance requirements. Owners commonly require that contractors provide them additional insured status under the contractor's general liability policy, and the general contractor in turn requires its subcontractors to provide it and the owner with additional insured status. This "additional insured" status is typically provided by endorsement or written amendment to the named insured's policy.

Since endorsements effectively add up-stream parties to the down-stream named insured's insurance contract, subject to the policy's exclusions and exceptions, as with any contract claim, they are resolved through an interpretation of the contract's terms. Therefore, claims made by additional insureds are handled just like any other contract claim, with the Court primarily interpreting the policy of insurance and any of its endorsements in order to make a determination of coverage. For this reason, up-stream parties must verify endorsements and policies provide the coverage they believe they are getting, and down-stream parties should verify they are providing the insurance they are required to under their contract.

Insurance requirements of construction contracts generally set forth the insurance coverage that must be provided. Such clauses specify: (a) the types of policies to be provided; (b) the number of years for which insurance coverage is to be obtained; (c) the insurance policy monetary limits; (d) the form of the policy ("claims made" vs. "occurrence"); (e) the hazards that are to be covered ("completed operations"); and (f) what evidence of compliance with these insurance requirements must be supplied. The down-stream party will need to comply with all of these requirements.

Certificates of Insurance

See: AIA A201 §11.1.3

A certificate of insurance typically is provided instead of an endorsement. A certificate of insurance is not itself a valid endorsement to a policy, and generally courts find certificates alone do not create coverage. Most certificates of insurance include disclaimers that state they do not alter the terms of the underlying policy, and do not create coverage if none otherwise exists. Further, certificates of insurance typically do not detail the specifics of what coverage is provided, do not reveal the number of other additional insureds under the policy, or whether there have been claims on the policy and what available limits remain. Also, the certificate does not require any notice of cancellation of the underlying policy, and it is incumbent on the policy holder to verify continued compliance through the contract term. An additional insured should always obtain the required endorsements instead of relying on certificates, as well as considering the coverage it is getting under the underlying policy.

While the AIA documents talk in terms of certificates of insurance, the ConsensusDOCS eliminate this language, and simply state that the terms of the policy shall comply with its requirements, forcing the parties to use an acceptable method to ensure compliance, but suggesting something more than merely a certificate of insurance.

Endorsements

Additional insured status is typically conferred by way of endorsement. A review of the endorsement or other policy language is critical to verifying compliance with the contract, as the insurer's obligation to the additional insured is governed by what the carrier agreed to do in its insurance contract with endorsements, not what the named insured agreed to do in its construction contract. Travelers Insurance Co. v. Dickey, 799 P.2d 625 (Okla. 1990).

See: AIA A201: The Contractor shall purchase...and maintain ...such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor's operations and completed operations under the Contract

ConsensusDOCS 200 Article 10.2.1: Before commencing the Work and as a condition precedent to payment, the Constructor shall procure and maintain in force Workers' Compensation Insurance, Employers' Liability Insurance, Business Automobile Liability Insurance, and Commercial General Liability Insurance (CGL). The CGL policy shall include coverage for liability arising from premises, operations, independent contractors, products-completed operations, personal injury and advertising injury, contractual liability, and broad form property damage. The Constructor's Employers' Liability, Business Automobile Liability, and CGL policies shall be written with at least the following limits of liability:

An issue typically litigated in these cases is the scope of whether the loss "arises out of" the named insured's work. The majority of courts construe "arising out of" language very broadly, requiring coverage not just limited to vicarious liability but for liability arising out of the named insured's work irrespective of whether the injury was caused by the named insured or the additional insured. Any activity on site by the named insured could lead to the conclusion that the claim "arose out of" their activity there. The minority view courts instead hold the phrase "arising out of" limits the additional insured's coverage to vicarious liability for the named insured's (the subcontractor) ongoing operations only. The important point is to ensure the proper endorsement is in play, which will determine whether losses "arising out of" the named insured's operations are covered. It is very important to note that both the AIA and the ConsensusDOCS provisions use the "arising out of" language.

There are several additional insured endorsements promulgated by ISO. When a named insured faces repeated demands to procure additional insured coverage, they can endorse their policy with a "blanket endorsement," which extends additional insured status to any person or company with whom the named insured has a contract requiring them to name an additional insured under its general liability policy. (CG 20 10 03 97). Additional insured status is typically limited to liability "arising out of" ongoing operations only performed by the named insured on the project specified in the construction contract. The significant role of this type of coverage is that an owner or general contractor is added automatically when the construction contract requires the provision of additional insured coverage, without need for a specific endorsement for the subject project.

ISO endorsement CG 20 10 07 04 is the most commonly used form to add a party as an additional insured. This endorsement was much broader prior to 2004, when the endorsement was significantly revised. Prior to 2004, the CG 20 10 endorsement, CG 20 10 11 85, provided the additional insured with coverage for liability “arising out of” the work of the named insured, while work was in progress and for completed operations. Courts consistently held there only need be a very casual connection between the work being done by the named insured and its liability to the additional insured. For example, the simple fact that the named insured was performing work for the additional insured was enough to invoke coverage as “arising out of,” even if the injury causing action was solely that of the additional insured. Many up-stream parties still request this older, more broad-form coverage endorsement even today.

The 2004 versions of the standard endorsements significantly alter coverages that were in place under earlier endorsements. First, the additional insured is covered only if the liability is “caused in whole or in part” by “the acts or omissions” of the named insured. It no longer uses the “arising out of” language of earlier endorsements, and so, immediately runs afoul of both the AIA and ConsensusDOCS contract requirements. It also excludes coverage for the sole negligence of the additional insured, meaning that suits against the additional insured may not be covered, even if the named insured was wholly at fault. Since the CG 20 10 provides that the additional insured is covered only if the liability is caused “in whole or in part” by acts or omissions of the named insured, if a lawsuit only alleges fault against the additional insured, this endorsement would not provide protection. Further, there is no protection for completed operations without an additional endorsement, CG 20 37 07 04. In order to comply with the form industry documents, both endorsements are required.

An example that highlights the issue can be found in the case of Transport International Pool, Inc. v. Continental Insurance Co., 166 S.W.3d 781 (Tex. App. 2005). In that case, Transport leased a piece of equipment to a contractor, whose employee was injured while using it. The lease agreement required contractor to indemnify Transport and to add them as an additional insured on contractor’s policy of insurance. The employee sued Transport, who tendered the suit to contractor’s insurance carrier, as an additional insured. Since the policy and endorsement in question excluded coverage caused by the sole negligence of the additional insured, and since the employee’s lawsuit only alleged the negligence of Transport, coverage was denied. The Court hearing the case agreed, noting that the “Eight Corners Rule,” (an examination of the “Four Corners” of the policy in question as well as the complaint), justified the decision. Since the lawsuit did not allege facts within the scope of coverage, there was none found.

More importantly, coverage under the CG 20 10 now excludes coverage for injuries or damage after work is completed or put to its intended use, requiring an additional endorsement for completed operations coverage. (CG 20 37 07 04). Both the AIA and ConsensusDOCS insurance provisions require completed operations coverage. An important issue for construction contractors is whether the additional insured endorsement covers completed operations. The owner or contractor who seeks an additional insured endorsement generally anticipates it will receive coverage for claims that arise during the project as well as for claims that arise after substantial completion, but not all endorsements provide both types of coverage. Courts that have considered this language found no problem restricting coverage available to the additional insured through the period of ongoing operations. E.g., Mountain Fuel Supply Company v. Reliance Insurance Company, 933 F.2d 882 (10th Cir. 1991); Pennsylvania Department of Transportation v. American States Insurance

Company, 588 A2d 1320 (Pa. 1991). However, these courts have found that the additional insured endorsement ends once that the named insured completes work on the project at issue.

See: AIA A201 §11.1.4

Another additional insured endorsement implicated in construction matters is CG 20 07 for architects and engineers. This endorsement automatically adds as an additional insured any architect, engineer, or surveyor hired by the named insured for liability caused by the named insured. This endorsement specifically excludes injury or damage arising from the architect's or engineer's professional liability in preparing plans and specifications or other architectural or engineering activities. The endorsement protects an architect or engineer from bodily injury or property damage claims occurring at a job site when the injury was caused, in whole or in part, by the acts or omissions of the named insured (typically an owner or general contractor).

“Other Insurance”

An issue that frequently arises in significant claims is the coordination of coverage between the carrier for the general contractor with carriers under which the general contractor is an additional insured. Coordination between policies is governed by the “other insurance” clauses in the competing policies. Usually, it is expected by the up-stream parties that their own coverage would be excess to coverage it is receiving on an additional insured basis, which it would consider primary. Typically, a CGL policies have language that makes it excess to coverage the insured receives as an additional insured. If this language is not in place in the policy, then the party's own insurer and the insurer treating the party as an additional insured typically are obligated to provide coverage on a pro-rata basis. Federal Insurance Company v. Insurance of North America, 580 N.Y.S.2d 295 (App. Div. 1992).

Exhaustion – Horizontal and Vertical

All policies of insurance contain “other insurance” clauses, which set their priority when other insurance policies may apply to the same covered loss. Many contracts require the additional insured coverage to be “primary,” and most named insured's policies state its coverage is excess over any other primary insurance, including additional insured coverage by endorsement. Most CGL policies are written on an “occurrence” basis, which could also create a situation where a number of different policy periods are triggered for the same covered loss. These issues create questions about what priority the policies will take, and how they are to be exhausted.

The concept of horizontal exhaustion holds that all primary policies will pay first before any excess policies are triggered. An example of this concept is found in the case of Kajima Construction Services v. St. Paul Fire & Marine Co., 879 N.E.2d 305 (Ill. 2006). The Illinois Supreme Court held that an insured is not allowed to use the “targeted tender” rule to excuse the performance of a primary policy and require an excess policy to drop down to perform in the place of the primary policy.

Vertical exhaustion allows an insured to seek coverage from an excess insurer as long as the insurance policies immediately beneath that excess policy, as identified in the excess policy's declarations page, have been exhausted, regardless of whether other primary insurance may apply. This concept was addressed by the Court in Carter-Wallace, Inc. v. Admiral Insurance Company,

712 A.2d 1116 (N.J. 1998). Citing Owens-Illinois, Inc. v. United Insurance Co., 650 A.2d 974 (N.J. 1994), the New Jersey Supreme Court adopted a “vertical exhaustion within policy period share” method for allocating multi-year coverage responsibility. Under that approach, the Court calculated the amount of coverage responsibility for each of the triggered years by determining that year’s allocations by the ratio of the year to other triggered periods in terms of the total amount of coverage (both primary and all levels of excess insurance). Then, each policy period was treated as one segment of insurance without regard to the designation of the insurers as “primary” or “excess.”

Some courts considered a mixed approach, depending on the policy language in question. In Padilla Construction Company, Inc. v. Transportation Insurance Co., 58 Cal. Rptr. 3d 807 (Cal. App. 2007), the court held to the policy of horizontal exhaustion, but opened the possibility of a mixed approach. If a policy says that it is excess over a specifically described policy, and that it will cover a claim when that policy is exhausted, then perhaps horizontal exhaustion will apply.

Care should be taken to make sure that the appropriate level of coverage is obtained on a primary basis. The risk to the additional insured is that a catastrophic loss may be covered, at least in part, by its own carrier, if the named insured was allowed to lower its primary coverage limits for additional excess coverage limits. This could result in an unintentional imposition of loss payments to the additional insured that it fully expected would be handled by another carrier.

Coverage for “Your Work” – Business Risk Doctrine

Standard CGL policy language typically excludes coverage for property damage to “your work” (the work of the insured), arising out of operations of the named insured. However, there is usually language accompanying this exclusion which indicates it does not apply if the damaged work was performed by a subcontractor. This exclusion is typically referred to as the “business risk exclusion,” which is designed to exclude coverage for defective workmanship of the named insured which causes damage to the work itself.

This exclusion is intended to preclude coverage under the CGL for the contractor’s failure to conform to the contractual requirements. This is considered a business risk of the insured to perform their contract properly. However, some states have allowed coverage for damage caused to the work itself due to faulty workmanship of subcontractors. The question will focus on whether the particular state law defines defective work of a subcontractor as an “occurrence.”

In those states allowing coverage for these types of claims, courts finding that the faulty work was performed without any intention or design to create problems could lead to finding it was a covered occurrence. See Sheehan Construction v. Continental Casualty, 935 N.E.2d 160 (Ind. 2010); and Lamar Homes v. Mid-Continent, 242 S.W.3d 1 (Tx. 2007) (Court found that allegations of construction defects in home was an “accident” and “occurrence” sufficient to trigger CGL and duty to defend. “Accident” was defined to include claims for damage caused by an insured’s defective workmanship, so long as not intentional or reckless.)

The insurance industry has responded and issued an endorsement: CG 22 94 10 01, which basically eliminates the subcontractor exclusion and returns the policy to one without coverage for damage caused by subcontractor work. However, some states have taken this matter into their own hands, and mandate coverage for these claims. As an example, Colorado Revised Statutes 10-4-110.4 and 13-20-808 requires courts to presume that the work of a construction professional that results in

property damage, including damage to the work itself or other work, is a covered “accident” unless the property damage is intended and expected by the insured.

Right of Subrogation

See: AIA A201 §11.3.7
ConsensusDOCS Article 10.3.3

The right of subrogation is typically reserved in insurance contracts by insurers to allow them to pursue recovery of claims expenses paid out against those parties that are the potentially responsible parties for causing the loss. However, under the law of most states, insurers are not allowed to subrogate as against their own insureds. This, the importance of getting additional insured status under other parties’ policies. However, the right to pursue subrogation can be contractually waived prior to the loss, and typically is in most form and custom construction documents.

“Additional Insured” Loophole

While most states prohibit enforcement of broad or intermediate form indemnity language in construction contracts with “anti-indemnity” statutes, the great majority of states allow parties to require insurance coverage with serves the same purpose of the very indemnity clauses it strikes down. This phenomenon is referred to as the “Additional Insured Loophole,” a gap in the anti-indemnity statutes that allows broad and intermediate form indemnity, if it is provided through the contract’s insurance provisions instead of the indemnity language.

However, through efforts of organizations like the American Subcontractors Association, (ASA), a few states have started to close this loophole, and now prohibit a party from requiring another party to name it as an additional insured under a policy of insurance which would provide broad form coverage. One such state is Oregon, who enacted a statute, Oregon Revised Statutes Section 30.140 (2009), upheld as constitutional by the Oregon Supreme Court in Walsh Construction Co. v. Mutual of Enumclaw, 338 Or. 1 (2005), which reads:

Except to the extent provided under subsection (2) of this section, any provision in a construction agreement that requires a person or that person’s surety or insurer to indemnify another against liability for damage arising out of death or bodily injury to persons or damage to property caused in whole or in part by the negligence of the indemnitee is void.

To see how these issues are addressed in the 50 states, see the below Table 2.0.

Table 2.0

50 State Anti-Indemnity Statutes and Additional Insured Loophole Issues

State	Prohibits Indemnity for Sole Negligence Only	Prohibits Indemnity for Sole or Partial Negligence	Closes A.I. Loophole	Comments
Alabama				No statute.
Alaska	X			Alaska Stat. §45.45.900. Except for hazardous substances.
Arizona	X (Private Work)	X (Public Work)		Ariz. Rev. Stat. §§ 32-1159, 34-226, 41-2586. Except for entry onto adjacent land.
Arkansas	X			A.C.A. §§ 4-56-104 (private) & 22-9-214 (public)
California	X			Civ. Code §§ 2782 et seq. Except for entry onto adjacent land.
Colorado		X (See Comments)		Colo Rev. Stat. §§ 13-21-111.5 (private) (exception for contracts pertaining to property owned by railroads) & 13-50.5-102 (public)
Connecticut		X		Conn. Gen. Stat. § 52-572k (P.A. 01-155).
Delaware		X	(See comments)	Del. Code, Title 6 §2704. (Additional insured requirement may be unenforceable but endorsement is not.)
D.C.				No statute.
Florida		X		Fla. Stat. § 725.06. If the project is a private property indemnity is allowed if there is monetary limitation and reproduction in bid documents. Also § 725.08 governs design professionals.

Georgia	X (See comments)			GA. Code § 13-8-2 has been gutted by intermediate level appellate courts creating an exception for hold harmless obligations that are insured.
Hawaii	X			Hawaii Rev. Stat. § 431:10-222.
Idaho	X			Idaho Rev. Stat. § 29-114.
Illinois		X		Ill. Compiled Stat. 740 ILCS 35/1-3.
Indiana	X			Ind. Code § 26-2-5-1, -2, highway construction exception.
Iowa				No statute.
Kansas		X	X	Kansas Stat. § 16-121 (also bars additional insured coverage for negligence of the additional insured); see also Kansas Fairness in Private Construction Contract Act, § 16-1801 et seq. which bars waivers of subrogation on claims paid by liability and workers' compensation insurance.
Kentucky		X		Kentucky Rev. Stat., chap 371.180.
Louisiana		X		La. Rev. Stat. §38:2216.G only protects prime contractors on public works. The Louisiana Oilfield Indemnity Act, La. Rev. Stat. Ann. §9:2780, as applied has been held to void both hold harmless and additional insured clauses.
Maine				No statute.
Maryland	X			Md. Code, Cts and Jdcl Pro, §5-401.
Massachusetts		X		Mass. Gen. Laws, ch. 149 § 29C.
Michigan	X			Mich. Comp. Laws § 691.991
Minnesota	X			Minn. Stat. §§ 337.01, 337.02
Mississippi		X		Miss. Code § 31-5-41.

Missouri	X (See comments)			Mo. Rev. Stat. §434.100. In fact, specifically allows broad form indemnity of covered by a policy of insurance.
Montana		X	X	Montana Rev. Code § 28-2-2111 prohibits requirements to "insure or defend" but authorizes owners and contractors protective liability coverage (OCP), and project management protective liability coverage (PMPL) and permits indemnity for the negligence, recklessness, or intentional misconduct of a third party or of the indemnifying party.
Nebraska		X		Neb. Rev. Stat. § 25-21,187.
Nevada		X		No statute.
New Hampshire				N.H. Rev. Stat. § 338-A:1 only prohibits indemnity of design professionals.
New Jersey	X			N.J. Stat. § 2A:40A-2.
New Mexico		X	X	N.M. Stat. § 56-7-1 prohibits requirements to "insure of defend" but authorizes OCP, PMPL and indemnity clauses limited to extent of liability of indemnifying party.
New York		X		N.Y. Gen. Oblig. Laws § 5-322-1.
North Carolina		X		N.C. Gen. Stat. § 22B-1.
North Dakota		X		N.D. Cent. Code 9-08-02.1. Only applies as between the contractor and the owner for errors or omissions of the owner.
Ohio		X	(See comments)	Ohio Rev. Code §2305.31. Split of authority as to applicability of statute under additional insured obligations.
Oklahoma		X	X	Okla. Stat. Titl.15 §221.

Oregon		X	X	Ore. Rev. Stat. § 30.140 prohibits subcontractor's surety or insurer from indemnifying another's negligence.
Pennsylvania				Pa. Stat., Title 68, §491, prohibits indemnity of design professionals only.
Rhode Island	X			R.I. Gen. Laws § 6-34-1.
South Carolina	X			S.C. Code § 32-2-10.
South Dakota	X			S.D. Codified Laws §56-3--16, 18, design and construction contracts.
Tennessee	X			Tenn. Code 62-6-123.
Texas		X(Public works only; injuries excluded)		Government Code §2252.902. Civ. P&R Code § 130.001, 002 only prohibits indemnity of design professionals.
Utah		X		Utah Code § 13-8-1 exception permits indemnity of owner.
Vermont				No statute.
Virginia	X			Va. Code § 11-4-1, 11-4-4, construction and design contracts.
Washington		X		Wash. Rev. Code §4.24.115. Indemnity is valid for current negligence under specific conditions.
West Virginia	X			W. Va. Code § 55-8-14.
Wisconsin		X		Wis. Stat. § 895.447. Does not apply to workers' compensation or insurance contracts.
Wyoming				No statute.

Delay Issues and Damages

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General:

Delays are typically measured from the contractually required completion date to the actual completion date. Delay damages are almost always addressed by a contractual liquidated damage provision. Under such provision, the owner is paid (by deduction from monies otherwise owed the contractor) an agreed daily rate for each day of delay of completion of the project that is not excused by a provision of the project. The liquidated damage rate is supposed to be a reasonable approximation of the damages that will actually be suffered by the owner due to a delay in completion.

Types of Delay:

For a claimant to demand payment of delay damages, it must prove (1) it suffered a delay; (2) the delay was caused solely by the contractor; and (3) there was no concurrent delay caused by the claimant or any excusable clause. Any such delay must be a compensable delay for payment to be incurred.

A. Delays are characterized as 4 types:

1. Excusable delay. Delay to completion of the project for which the contractor is entitled to a time extension, but not compensation under the terms of the contract. Some common examples are weather, strikes, or acts of god;
2. Nonexcusable delay. Delay to completion of the project for which the contractor is not entitled to a time extension under the terms of the contract. Some common examples are delays caused by late deliveries of contractor ordered materials, subcontractors failures, or simply taking longer than planned to perform a particular aspect of construction;
3. Compensable delay. Delay to completion of the project for which the contractor is entitled to both a time and extension as well as associated damages under the terms of the contract. Some common examples are owner directed changes and differing site conditions;
4. Concurrent delay. Multiple delays which occur that at least partially overlap with each other. This term is generally only used to describe overlapping delays that are of different types of delays.

Methods used to analyze and improve construction delays.

The most common methods utilize a **critical path** for the following analysis of those asserted

delays.

- A. Impact as planned schedule analysis. This method requires an agreed baseline schedule and known delays are inserted into the plan's schedule and the schedule recalculated to determine the extended duration of the delays. Such a method is most appropriate for simple linear type projects.
- B. Collapsed as built schedule analysis. A reverse approach is used where the analysis begins with the as built schedule and when the analysis is performed after the completion of the project identifying delays, subsequently, the schedule is collapsed by the delays identified to determine what the net effect on the project timing is from such delays. This method is used when no baseline exists or when the project is a design build type project with a constantly changing schedule.
- C. Total time analysis. Such an analysis subtracts the estimated project duration from the actual project duration and states that the differences are entirely due to compensable delay. However, the claimant must prove that no other analysis method is available to determine the delay, its plan duration was reasonable, the actual time taken was reasonable, and it caused none of the delay itself.
- D. Contemporaneous period analysis/time impact analysis. Such an analysis is usually performed using a contractually required monthly schedule update for each month. Any known delays are identified and added to the schedule which is then recalculated to determine what delay occurred during the month. Contemporaneously, the parties then attempt to agree on which delays are excusable and which are compensable. This analysis works if the parties can follow in real time and it does have the advantage of being self-correcting if the impact of an event is more or less than expected in the analysis from the previous month.

Elements of Delay Damages

Common damages that may result from delays include the following:

A. Pure delay damages:

1. Extended site overhead
2. Extended equipment rental and/or equipment standby
3. Cost escalation for labor, materials, subcontractors and equipment
4. Weather
5. Loss of Learning curve for new construction crews
6. Home office overhead
7. Interest

1. Extended Site Overhead. Such site overhead costs are time variable costs are not necessarily uniform over the life of the project. Thus, it is important to match the delay period to the cost incurred in that period. Typically these costs begin low as

mobilization takes place, increase to a normal level during the main phase of the project and then taper off as the project work itself tapers.

2. Extended Equipment rental and/or Equipment Standby. Similar to extended site overhead, the cost of equipment also needs to match the delay period to the cost incurred in that period. Usually, the contract itself has provisions dealing with equipment rates and standby equipment rates to handle such situation.
3. Cost Escalation. The most common part of cost escalation is the escalation of labor rates. Another issue may be fuel costs if such costs are highly variable during this time.
4. Weather. The best way to prove such delay damages due to weather is to compare the cost of doing the work when it was originally scheduled with the cost of doing the work when it was scheduled. Such a situation is called a "measured mile." However, lacking a measured mile it may be possible to have such effects measured by academic studies or by having an expert show how this work was actually performed under both conditions.
5. Loss of Learning Curve. Once again, a "measured mile" analysis is best, however not always possible and there are a number of industry studies that attempt to determine the effect of a learning curve on construction productivity. Again, in using these studies it is also appropriate to have actual experts who can provide input as to what the effects really were under the varying conditions.
6. Home Office Overhead. This is an area of damage that is very contentious and as a result many contracts explicitly state how this element of damages is to be calculated. In addition, for federal projects, there is a formula that has been used to calculate this cost called the Eichleay Formula. Such a formula takes the percent revenue for the affected contract, divided by the total company revenue and multiplies it by the total home office overhead during the original contract period. The total overhead allocable to the project is then divided by the actual duration to come up with a daily overhead rate which can be used as a measure of delay damages.
7. Interest. Interest is not easily calculable delay damage and is also dependent upon the contract language itself and applicable state or federal law.

B Acceleration damages:

1. Overtime labor premium
2. Multiple shift labor and support costs
3. Lost labor productivity due to:
 4. Working overtime
 5. Working Shiftwork
 6. Stacking up of trades
 7. Dilution of supervision
 8. Excessive crew movement

9. Fatigue
10. Moral
11. Impaired logistics
12. Site access
13. Concurrent operations
14. Joint or beneficial occupancy
15. Increased crew sites

Underneath the category of acceleration damages, most of these inefficiencies are difficult to price with any degree of precision. The preferred method is to find a "measured mile" and compare an unimpacted period with an impacted period.

If that is not possible, there are a wide assortment of industry studies available which can be utilized to make such determination. Key to doing so however, is assuring that the appropriate studies are used and a similar factual situation exists and the construction project is adequately modeled and addressed in the study selected for the delay damage calculation. It is vital to talk with the craft personnel who did the work and to have an appropriate expert identified who can compute and testify to those damages in the context of project personnel's experience.

Conclusion

Proving each of these types of damages, pure delay damages and acceleration damages, is difficult, hard to quantify and subject to many interpretations. Consequently, determining damages in the area of construction litigation is subject to Judicial interpretation and usually hotly contested between the parties.

Liquidated Damages

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Liquidated damages are a contractual device that allows a party to avoid having to prove actual damages upon a contract breach. While liquidated damages may be used for recovery of all damages in a specific performance type contract, typically in construction contracts, liquidated damages are designed to cover only delay damages.

The contractual right of parties to agree to a liquidated damages clause is unquestioned. While under common law, stipulated sums for damages were generally viewed as a penalty and were not allowed, as the principal of “freedom to contract” became more accepted, the courts began to accept liquidated damages clauses. The “freedom to contract” principal continues to be tempered by the common law tradition that stipulated damages should not make the breach significantly more expensive to the breaching party as compared to the benefit to the non-breaching party. (*Farnsworth and Young, Contract: Cases and Materials* (5th Ed. 1995)). In essence, the party’s “freedom” to set the amount of liquidated damages is offset by the penalty doctrine that originated in common law. Therefore, liquidated damages are not enforceable if they are found to be a penalty.

What Constitutes a Penalty?

Generally, liquidated damages will be enforceable if they are “reasonable in light of the anticipated actual loss caused by the breach and the difficulties of proof of loss”. (See *Restatement Second, Contracts* Section 356(1)). Reasonableness is not determined with the gift of hindsight; it is based on information available at the time of contracting.

Given the wide latitude in the legal definition of “reasonableness”, what constitutes a penalty is often jurisdiction specific. Generally, liquidated damages will be considered a penalty if there is an intent to punish for breaching the contract. “It is well settled contract law that courts do not give their imprimatur to stipulated damages that serve as an added spur to performance.” (*Priebe & Sons vs. U.S.*, 332 U.S. 407, 413, 68 S. Ct. 123, 92 L. Ed. 32 (1947)). Liquidated damages will also be considered a penalty if the amount of liquidated damages is grossly higher than the foreseeable actual damages. “Any disparity [between liquidated and actual damages] must be ‘grossly excessive’ and must ‘shock the conscience’ of the court before we declare the liquidated damages void.” *Reliance Ins. Co. vs. Utah Dept. of Transp.*, 858 P.2d 1363, 1367 (Utah 1993).

Are Liquidated Damages an Exclusive Remedy?

Liquidated damages may be an exclusive remedy if so designated in the contract. However, if the contract does not specifically provide that the liquidated damages are the exclusive remedy, the non-breaching party may be allowed to choose between liquidated damages and actual damages.

Unlike the AIA standard documents which remind the contract preparer to include a liquidated damages provision if desired, the ConsensusDocs provides standard liquidated damages provisions.

The standard liquidated damages provisions in the ConsensusDocs specifically note that liquidated damages are in lieu of actual damages. In ConsensusDoc 200 subparagraph 6.5.1.1, it provides:

“The liquidated damages provided herein shall be in lieu of all liability for any and all extra costs, losses, expenses, claims, penalties, and any other damages of whatsoever nature incurred by the owner which are occasioned by any delay in achieving the date of substantial completion.”

Defenses

A. Substantial Completion

Once a contractor has achieved substantial completion, unless the contract specifically provides otherwise, the liquidated damages are stopped. (*Walton General Contractors, Inc. vs. Chicago Forming, Inc.*, 111 F.3d 1376 (8th Cir. 1997).

If the contract specifically provides for liquidated damages through final completion, these provisions will likely be enforced. (*Ledbetter Bros., Inc. vs. North Carolina DOT*, 68 N.C. App. 97, 314 S.E.2d 761 (1984).

ConsensusDoc 200 specifically provides for liquidated damages at substantial and final completion.

B. Waiver

The owner may waive its rights to collect liquidated damages if it:

1. Allows the contractor to continue performance without objection after the completion date passes and does not raise the liquidated damages clause. (*Sun Cal, Inc. vs. U.S.*, 21 Cl. Ct. 31, 39, 1990 WL 94817 (1990));
2. Requires the contractor to perform extra work after the scheduled completion date. (*Rockwell vs. Mountain View Elec. Ass'n, Inc.*, 521 P.2d. 1272,1274 (Colo. Ct. App. 1974)); and
3. Makes final payment without withholding liquidated damages. (*Alpine Const. Co. vs. Water Works Bd of City of Birmingham*, 377 So. 2d 954 (Ala. 1979)).

C. Excusable Delays

Liquidated damages may only be assessed for unexcused delays. If the contractor is able to demonstrate through a schedule analysis or contract provision that all or a portion of the late completion is excused, then the number of delay days subject to liquidated damages will be adjusted accordingly.

Waivers of Incidental and Consequential Damages

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Significance of the Clause:

In a breach of contract claim, Restatement (2nd) of Contracts at Section 347 provides the general measure of damages as follows:

Subject to the limitations stated in Sections 350-53, the injured party has a right to damages based on his expectation interest as measured by

- (a) the loss of the value to him of the other party's performance caused by its failure or deficiency, plus
- (b) any other loss, including incidental or consequential loss, caused by the breach, less
- (c) any cost or other loss that he has avoided by not having to perform.

Typically, courts allow under subsection (a) the recovery of direct damages which represent the loss to the injured party by the other party's failure of performance, such as the difference between the value that the full performance would have had to the injured party less the value of the performance actually rendered.

Incidental and consequential losses have not been consistently defined by the courts in construction contracts. This inconsistency has resulted from the concept that such losses are recoverable if they were reasonably foreseeable by the parties at the time of the contract, or in some circumstances, simply considered to be the natural and probable result of the breach of the contract. In contracts for the sale of goods, incidental and consequential damages have been defined in the Uniform Commercial Code, while in construction contracts, the parties themselves have attempted to define such losses and to limit their recovery in the contracts they enter.

Construction contracts are ordinarily a mixture of a sale of goods and a contract for services. To the extent such agreements are service contracts, the Uniform Commercial Code does not apply. Code provisions can, however, assist the courts in applying common law principles which generally were codified in the Uniform Commercial Code.

Incidental damages are defined in the Uniform Commercial Code as any commercially reasonable charges, expenses or commissions incurred relative to delivery, expenses for transportation, care and custody of goods, expenses in connection with obtaining other goods to cover the loss, plus reasonable expenses incident to delay. Uniform Commercial Code, Sections 2-710 and 2-715.

Under the Code, a buyer is entitled to recover consequential damages which are defined as losses resulting from general or particular requirements and needs of the buyer, of which the seller at the time of contracting had reason to know and which could not have reasonably been prevented by obtaining substitute goods or otherwise, and injury to person or property proximately caused by breach of warranty, without regard to whether the seller anticipated such injuries at the time of contract. Uniform Commercial Code Section 2-715.

In a sale of goods, the Uniform Commercial Code allows the parties to limit their damages and modify or limit their remedies by contract. The parties can contractually limit damages, determine that particular remedies are exclusive and even exclude consequential damages, so long as such exclusion is not unconscionable. Uniform Commercial Code, Sections 2-718 and 2-719. A limitation of consequential damages for injury to a person in a case of consumer goods is *prima facie* unconscionable, but where a loss is commercial, limitation of such damages is not. Uniform Commercial Code, Section 2-719(3).

Examples of Incidental and Consequential Damages:

Incidental Damages

Courts have dealt with many claims for incidental damages and have found the following to be types of incidental damages for which recovery is allowed, absent their limitation or exclusion: expenses incurred in rejecting non-conforming goods, expenses incurred in obtaining substitute goods and caring for, storing and insuring rejected goods, overtime labor, additional finance charges, handling charges in connection with rejected goods, such as restocking charges, testing the goods to determine if they comply with the contract, attempts to repair defective goods, reasonable resale expenses, and expenses of restoring premises to their original condition when rejected goods have already been installed and had to be removed.

Consequential Damages

Consequential damages are special damages which do not necessarily always result from the breach of contract. Instead, they flow from the breach of contract and were foreseeable. An award of consequential damages must be reasonable and cannot be punitive. Courts have found the following to be consequential damages: idle or down time, extra overhead, extra labor, loss of use, lost profits, lost reputation and lost good will.

Sample Clauses:

Although many construction contracts are custom contracts designed for particular projects, the industry has developed form contracts that have been widely used with varying degrees of modifications for individual projects.

AIA Document A201-2007, *General Conditions for the Contract for Construction* provides for a mutual waiver of consequential damages at Section 15.1.6. That clause states:

15.1.6. CLAIMS FOR CONSEQUENTIAL DAMAGES

The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes

1. damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
2. damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Section 15.1.6 shall be deemed to preclude an award of liquidated damages, when applicable, in accordance with the requirements of the Contract Documents.

Consensus Docs 200 Standard Agreement and General Conditions Between Owner and Constructor (Lump Sum Price) provides at Section 6.6 as follows:

Section 6.6. Limited Mutual Waiver of Consequential Damages. Except for damages mutually agreed upon by the Parties as liquidated damages in Section 6.5 and excluding losses covered by insurance required by the Contract Documents, the Owner and the Constructor agree to waive all claims against each other for any consequential damages that may arise out of or relate to the Agreement, except for those specific items of damages excluded from this waiver as mutually agreed upon by the Parties and identified below. The Owner agrees to waive damages, including but not limited to the Owner's loss of use of the Project, any rental expenses incurred, loss of income, profit or financing related to the Project, as well as the loss of business, loss of financing, loss of profits not related to this Project, loss of reputation or insolvency. The Constructor agrees to waive damages, including but not limited to loss of business, loss of financing, loss of profits not related to this Project, loss of bonding capacity, loss of reputation or insolvency. The provisions of this section shall also apply to the termination of this Agreement and shall survive such termination. The following are excluded from this mutual waiver: _____.

Practice Notes:

Waivers of consequential damages are generally upheld in cases involving business entities such as contractors, subcontractors, suppliers and developers, unless the clauses are found to be too vague to apply, exercised in bad faith, in violation of a particular state's anti-indemnity law or public policy, inconsistent with other contract provisions, inapplicable to tort damages because of the specific contract language, inapplicable to subcontractors or suppliers or violative of a particular state's law regarding the doctrine of waiver.

Careful drafting of clauses for the waiver of consequential damages will include as many examples of consequential damages as possible, preceded by the phrase "including but not limited to." The defense to application of such clauses naturally, therefore, is based on careful analysis of the wording of the clause, plus application of the particular jurisdiction's law relating to the recovery of such damages and the enforceability of such waivers.

The courts have confused incidental and consequential damages, often using the terms interchangeably. That confusion can and should be overcome with careful drafting of waiver provisions which clearly delineate the damages the parties agree to refrain from asserting against each other in the event their good relations end in dispute.

Dispute Resolution and Avoidance on Construction Projects

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Disputes on construction projects are inevitable. A construction project involves a variety of construction participants performing different functions all pursuant to different contracts. There are a multitude of tasks and sub-tasks which must be performed in connection with one another with very little tolerance for error. One construction participant's failure to perform its obligations on the project can significantly impact other participants' abilities to perform their work. Because of the likelihood of disputes on a construction project, construction participants should invest the time and effort before the project begins to avoid disputes and develop a mechanism for resolving disputes in a timely and cost effective manner.

Dispute Avoidance:

There are several things that a construction participant can do prior to a construction project to avoid construction disputes. The first is to understand what may cause construction disputes to arise. The following are some of the leading factors which result in construction disputes:

1. Contract documents which are unclear in their definition of scope, responsibility, and contract requirements;
2. Poor communications in administration of the project and/or poor project management;
3. Lack of experience or capabilities on the part of one of the major participants in the project; and
4. A risk and reward system that is out of balance including situations where a construction participant takes on a significant amount of risk over which he has no control or where a project is underfunded.

Once the construction participant understands what can lead to a construction dispute, there are several things it can do to avoid disputes. The following are some of the leading factors that construction participants should consider in order to avoid construction disputes:

1. A contractor should have the ability and willingness to recognize and walk away from a contract that contains unreasonable and uncompensated risks or risks over which the construction participant has no control;
2. The contract documents should be clear and complete and clearly define the scope, responsibility and requirements at all levels of the project;
3. There should be experienced management and stable companies involved at every level of the project; and
4. The construction participant should ensure that the project administration includes thorough planning and systematic review and evaluation of project

conditions and has the ability to quickly react as those conditions change during the course of the project.

In addition to these factors, a clearly defined dispute resolution method should be agreed to by the parties prior to the project. The dispute resolution procedures should attempt to resolve disputes early in the project rather than waiting until the end of the project. The construction contract should clearly define the dispute resolution procedures. The dispute resolution provision in the contract should provide for timely resolution of disputes, incorporate a series of progressive steps for resolution prior to litigation and allow the exhaustion of every effort to resolve the dispute before turning the resolution of the dispute over to an unknown third party.

Dispute resolution can be accomplished through various methods. The typical methods of dispute resolution are mediation, arbitration or litigation. Also, the use of a project neutral on the project can help resolve disputes at the time they arise on the project.

Project Neutral:

A project neutral is a trained alternate dispute resolution specialist who is on call as needed during the construction project to mediate disputes that cannot be resolved at the project level. The project neutral has no adjudicatory authority but acts solely as a mediator with the parties to the dispute. The use of a project neutral is gaining acceptance in the construction as a way to resolve disputes early in the project. The advantage of a project neutral is that it allows disputes to be resolved quickly and efficiently at the time they arise on the project. It also allows the project team to maintain control of the claim without the outside intervention of third parties. By resolving disputes early, it allows the project to stay on schedule and avoids the time and expense of protracted claims resolutions after the project.

The disadvantage of a project neutral is that a project neutral is often not effective in resolving large complex disputes or disputes where all of the facts or information related to the dispute is not available. Because the project neutral attempts to resolve the dispute as the project is progressing, the parties often have not been able to adequately prepare their claims and defenses and, as a result, the claim does not get resolved.

Mediation:

Mediation is a form of dispute resolution in which a third party, mediator, assists the parties to negotiate a settlement of the dispute. Construction professionals often use mediation to resolve disputes in order to avoid the substantial costs associated with litigation and arbitration. Selection of the correct mediator is important. It is important that the mediator be trained in mediation techniques as well as knowledgeable of the construction industry construction disputes.

The advantage of mediation is that it allows the parties to reach an agreement to a dispute on their own terms rather than turning the decision over to a third party such as an arbitrator, judge or jury. It gives the parties to the dispute more control over the dispute resolution process. Mediation also allows for the resolution of multiple claims and parties in one proceeding rather than proceeding in multiple forums.

Mediation can be and is often used prior to initiating arbitration or litigation in order to attempt to resolve the dispute quickly without the protracted cost of arbitration or litigation. However, sometimes mediation is used after an arbitration or lawsuit has been filed. It is sometimes necessary to wait to mediate until after the claims and defenses have been established by the parties through discovery. Although there is a cost associated with waiting to mediate until after a period of initial discovery, this process allows the facts to be more fully developed and allows the parties to see the relative strengths and weaknesses of their claims and defenses. The sooner the parties can resolve their disputes through mediation, the less expensive the dispute resolution process will be.

Arbitration:

Arbitration is a method of dispute resolution in which the parties agree to be bound by the decision of a third party arbitrator. In construction disputes, the arbitrator should be knowledgeable of the construction industry and of construction disputes. Arbitration is a voluntary process and arbitration often is used because the construction contract contains a clause which requires disputes to be resolved through arbitration. An arbitration is usually initiated after a dispute has not been resolved through negotiations or mediation. It begins by one party filing a Demand for Arbitration with an entity such as the American Arbitration Association. The parties then select either one arbitrator or a panel of arbitrators, depending on the size and complexity of the claim. The procedures governing the arbitration are defined in the arbitration agreement or incorporated procedures used by the entity administering the arbitration. The arbitrator's job is to manage the arbitration and ultimately render a binding decision.

One significant advantage of arbitration is that the decision maker is more knowledgeable about construction issues and disputes than a decision maker in litigation. In litigation the decision maker is either a judge or a jury neither of whom normally have experience with construction disputes. The arbitration process is also more flexible to handle technical issues and craft creative resolutions than is the litigation process. Arbitration also has less rigid rules of evidence and procedure than does litigation which avoids the process from getting delayed with procedural issues. Arbitration is also normally faster than litigation. Arbitration allows the parties flexibility in controlling the way the dispute is handled.

Arbitration can be less expensive than litigation if the parties agree to limited discovery and limited time for the arbitration itself. However, arbitration can also be more expensive than litigation if the parties proceed with the same amount of discovery and case presentation as they would in civil litigation. This is especially true since the parties have to pay the arbitration administration fee and the arbitrator's fee. Another disadvantage of arbitration is that arbitrators are less likely to decide a case on the law. Hence, if you have a strong legal argument you might prefer to have a judge decide the case. Finally, a disadvantage of arbitration is that there is very limited right to appeal.

Litigation:

Litigation is a dispute resolution process in which one party brings a lawsuit in a state or federal court against another party. In general, litigation will take longer than arbitration and may be more costly. In litigation, the decision maker will either be a judge or a jury. A judge or a jury will not have the knowledge and background about construction disputes that an arbitrator will have. This could be an advantage or disadvantage depending upon the nature of your claim. If your construction claim is weak but your client might engender sympathy, you might prefer litigating the

claim rather than submitting it to an arbitrator. Juries sometimes tend to disregard the law and decide cases based on emotions or empathy rather than the facts and law. You might also want to litigate the case if you have a strong legal argument because courts are more likely to decide cases on the law. For example, if you are defending a delay claim and there is no damage for delay clause in the contract, you might prefer to be in court to allow a judge to rule on whether that clause precludes the delay claim as a matter of law. Arbitrators are normally less likely to dismiss claims based solely on the law.

Litigation will also be governed by the Rules of Civil Procedure and the Rules of Evidence. These procedural requirements often cause litigation to be more time consuming because the litigants are spending more time arguing over evidentiary and procedural issues. However, this can work to your advantage. If, for example, you want to make sure certain evidence is excluded, then you might prefer to have the case in court as opposed to arbitration.

Another distinctive feature of litigation is that it will often take longer than arbitration to reach a final disposition of the case. Court cases can often take as long as two years or longer before going to trial whereas arbitrations can sometimes be held within a few months. In litigation the parties also have an unlimited right to appeal. Therefore, a case which takes two years to go to trial could then take another two years on appeal. Consequently, litigation can be much more time consuming.

Finally, litigation is normally more costly than arbitration. In arbitration, the parties can limit the amount of time spent on discovery as well as time spent arbitrating. When parties are in litigation, they tend to spend more time taking discovery than if they were in arbitration. However, unlike arbitration where the parties have to pay the arbitrator's fee, the cost to file a civil action is minimal.

Arbitration Provisions

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Significance of the Clause:

Arbitration is no longer mandatory in either the AIA 2007 A201 Documents or the Consensus DOCS 200. Nonetheless, parties still have the option of selecting arbitration as a method of binding dispute resolution. Under the AIA Documents, parties must submit their claims to an Initial Decision Maker (IDM) and, if that fails, to mediation as conditions precedent to arbitration. The Consensus DOCS provide similar conditions precedent to arbitration, requiring that the parties first try to resolve their claims through “Direct Discussions” between representatives of the parties and, if that fails, the parties can try to resolve their disputes through “Mitigation” with either a Project Neutral or a Dispute Review Board. The Consensus DOCS then provide for mandatory mediation if Direct Discussions and Mitigation fail. Only after mediation has failed are the parties required under the Consensus DOCS to participate in arbitration or litigation, whichever of the two binding dispute resolution procedures is selected. Often construction contracts still contain mandatory arbitration provisions making arbitration compulsory for the parties to the contract and, in some cases, even non-signatories to the contract (discussed below). For purposes of this discussion, it is assumed that the contract has selected arbitration as a mandatory dispute resolution procedure.

Arbitration is often more cost-effective and efficient than litigation. The arbitration discovery process can range from being very limited to being broader than what may ordinarily be permitted under state and federal procedural rules, which do not apply to arbitration. There is great flexibility in dictating the terms under which an arbitration can proceed, such as through the use of “high-low agreements” whereby the parties can choose the limits within which an award must be rendered. Moreover, arbitration is a non-public proceeding that can be made confidential.

Sample Clauses:

AIA “General Conditions of the Contract for Construction” (2007)©:

15.4.1 If the parties have selected arbitration as the method for binding dispute resolution in the Agreement, any Claim subject to, but not resolved by, mediation shall be subject to arbitration which, unless the parties mutually agree otherwise, shall be administered by the American Arbitration Association in accordance with its Construction Industry Arbitration Rules in effect on the date of the Agreement.

(Published by the American Institute of Architects).

Consensus DOCS 200 “Standard Agreement and General Conditions Between Owner and Contractor”©:

12.5 BINDING DISPUTE RESOLUTION If the matter is unresolved after submission of the matter to a mitigation procedure or to mediation, the Parties shall submit the matter to the binding dispute resolution procedure selected below.

Arbitration using the current Construction Industry Arbitration Rules of the AAA or the Parties may mutually agree to select another set of arbitration rules. The administration of the arbitration shall be as mutually agreed by the Parties.

Litigation in either the state or federal court having jurisdiction of the matter in the location of the Project.

(Published by Consensus DOCS).

Practice Notes:

Arbitration provisions are subject to the normal rules of contract law and a written agreement to arbitrate will generally be enforced according to its terms. Consultants and Builders, Inc. v. Paducah Federal Credit Union, 266 S.W.3d 837 (Ky. Ct. App. 2008). However, any ambiguities in an arbitration agreement will be construed against the party who drafted the agreement. Blimpie Intern., Inc. v. Choi, 822 N.E.2d 1091 (Ind. Ct. App. 2005). Public policy strongly supports enforcing arbitration provisions, and courts will generally construe any uncertainties regarding whether a dispute falls within the scope of an arbitration agreement in favor of compelling arbitration. Auchter Co. v. Zagloul, 949 So.2d 1189 (Fla. Dist. Ct. App. 1st Dist. 2007). This is certainly also true under the Federal Arbitration Act. Suburban Leisure Center, Inc v. AMF Bowling Products, Inc., 468 F.3d 523 (8th Cir. 2006).

As a general rule, only parties to an arbitration agreement can invoke an arbitration provision. Horseshoe Entertainment v. Lepinsky, 923 So. 2d 929 (La. Ct. App. 2d Cir. 2006). Nonetheless, courts have shown a willingness to compel non-signatories to arbitration agreements to arbitrate their disputes in certain instances. There are essentially five doctrines through which a non-signatory can be bound by arbitration agreements entered into by others:

(1) assumption, (2) agency, (3) estoppel, (4) veil piercing, and (5) incorporation by reference. Zurich American Ins. Co. v. Watts Industries, Inc., 417 F.3d 682 (7th Cir. 2005).

In practice, it is not always clear under what circumstances courts will compel a non-signatory to arbitrate a dispute. For instance, in Associated Glass, Ltd. v. Eye Ten Oaks Investments, Ltd., 147 S.W.3d 507 (Tex. App. San Antonio 2004), a building owner who asserted claims against a glass subcontractor and a masonry subcontractor was compelled to arbitrate its disputes even though the building owner was not a party to the subcontract. The court reasoned that the building owner was bound by the arbitration provisions in the subcontracts because the disputes arose out of the subcontractors' contractual duties to the general contractor and the subcontract contained an arbitration provision. Conversely, in MPACT Const. Group, LLC v. Superior Concrete Constructors, Inc., 802 N.E.2d 901 (Ind. 2004) subcontractors were not compelled to arbitrate their disputes against a general contractor even though the subcontracts contained provisions stating that the subcontracts were to be complimentary to the general contractor's contract with the owner, which contained an arbitration provision. The court found it significant that the subcontracts did not conform to the requirements of the general conditions concerning the general contractor and the owner.

Venue Provisions

Significance of the Clause:

Venue provisions or forum selection clauses, as their names suggest, are used to designate a particular state or court as the jurisdiction in which parties will litigate disputes arising out of a contract and their contractual relationship. Such clauses allow parties enormous flexibility in predetermining what jurisdiction will decide their disputes should there be any. Venue provisions often select the owner's principal place of business. Obviously, this allows the party drafting the contract to ensure home-field advantage, which in some instances may prove to be outcome determinative. Both the AIA Documents and the Consensus DOCS allow parties to choose a venue.

Sample Clauses:

AIA "General Conditions of the Contract for Construction" (2007)©:

15.4.5.1 Venue for any litigation filed under or in connection with this Contract shall be determined in accordance with the terms of the Agreement.
(Published by the American Institute of Architects).

Consensus DOCS 200 "Standard Agreement and General Conditions Between Owner and Contractor"©:

12.5.2 VENUE The venue of any binding dispute resolution (i.e., arbitration or litigation) shall be the location of the Project unless the Parties agree on a mutually convenient location.
(Published by Consensus DOCS).

Practice Notes:

The enforceability of forum selection clauses is generally a matter of contract and not an issue of proper venue. Kerobo v. Southwester Clean Fuels, Corp., 285 F.3d 531 (6th Cir. 2002). However, some states statutorily proscribe forum selection clauses. See Montana Code Ann. § 27-5-323. Notwithstanding a statutory exception, forum selection clauses are enforceable unless enforcement would be unreasonable and unjust. In re Lyon Financial Services, Inc., 257 S.W.3d 228 (Tex. 2008). A forum selection clause can be as broad as selecting only a particular state or as narrow as selecting a particular court. For instance, in Fendi Adele S.R.L. v. Burlington Coat Factory Warehouse Corp., 689 F.Supp. 2d 585 (S.D. N.Y. 2010), the court enforced a forum selection clause in a purchase order between a retailer and vendor providing that any disputes concerning the contract should be venued specifically in the New Jersey Superior Court for Burlington County.

It should be noted that the precise language used in a forum selection clause will be controlling. For example, a forum selection clause stating that, "Jurisdiction and venue . . . shall lie exclusively in, or be transferred to, the courts *of* the State of Virginia," has been construed to mean that venue is proper only in Virginia state courts and not proper in federal courts sitting in Virginia. Findwhere Holdings, Inc., v. Systems Environment Optimisation, LLC, 626 F.3d 752 (4th Cir. 2010) (emphasis added). The rationale is that forum selection clauses using the term "*of* a state" expresses the parties'

intent as a matter of the sovereignty of the forum thereby limiting venue to state courts. On the other hand, use of the terms “*in* a state” expresses the parties’ intent as a matter of geography and includes venues in both state and federal courts.