ON-TIME AND ON-BUDGET:
KEY ISSUES IN NEGOTIATING CONSTRUCTION CONTRACTS

ACC REAL ESTATE COMMITTEE PRESENTATION
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I. Introduction

This presentation covers key issues to be considered in negotiating a construction contract. The presentation focuses on the Owner’s perspective, with particular emphasis on issues that impact the contract price and schedule. Accompanying this outline is a copy of the AIA’s standard form of guaranteed maximum price construction contract (AIA Documents A102 and A201), which has been modified to address certain issues covered in this presentation.¹

II. Major Types of Construction Contracts

A. AIA Series

1. The American Institute of Architects (AIA) publishes a series of design and construction contracts and related forms. While there are organizations that publish rival forms, and many owners and contractors have their own forms, of course, the AIA series tends to be the most commonly used.

2. Contractors, design professionals and owners favor the AIA forms because they are integrated (the design and construction contracts, as well as related certificates for progress payments, change orders, bonds, and the like, are designed to work together).

3. Negotiation of agreements is facilitated because the parties know the base forms well and are able to focus on the changes.

B. Key Forms

1. The primary forms of construction contracts are:

   (a) Lump Sum/Fixed Price (AIA A101)

¹ Of course, numerous other topics are also of importance in any construction contract, some of which are listed in the last part of this outline. The sample form of contract furnished with this outline would require additional modifications to address those issues and other matters unique to any project.
(b) Guaranteed Maximum Price (AIA A102)

(c) Construction Management Where Construction Manager is also the Contractor (AIA A121 CMc)

(d) Design/Build Agreement (AIA A141)

2. The A101, A102 and A121 CMc forms set forth the primary business terms for the contract. The boilerplate “General Conditions” are set forth in the A201.

3. The AIA also has a series of small project forms that work well for routine office buildouts and the like.

4. A rider of key provisions (progress payments, insurance, indemnification) is useful to attach to contractor proposals if negotiation time is short and the project is of limited scope.

III. Keeping the Project On-Budget

A. Contract Sum.

1. The contract provides that the total compensation to the Contractor for the cost of the work plus overhead and profit will either be equal to a lump sum price (AIA Document A101) or will not exceed the Guaranteed Maximum Price (“GMP”) (AIA Document A102).

2. However, there are provisions that enable the Contractor’s compensation to exceed the Lump Sum or GMP. The Owner’s objective is to plug those holes.

B. Incomplete or Inconsistent Documentation.

1. Per Section 2.1 of the A102, the Contractor is responsible for constructing the Work described in the Contract Documents, which include the A101/A102, the A201, Drawings, Specifications, and other documents enumerated in the contract. However, the Contract Documents may be incomplete or inconsistent.

2. Section 1.2.1 of the A201 should be modified to establish a priority among the Contract Documents and to resolve inconsistencies within Contract Documents.

3. The higher quantity and greater quantity should prevail in the event of conflict.

4. Consider adding language such as Section 7.1.4 of the modified A201 included in the materials, which acknowledges that there may be details to complete in the Drawings and clarifies that the Work includes any work that is “reasonably inferable” from the Contract Documents.
C. **Clarifications and Qualifications.**

1. The Contractor will typically include a schedule of “Clarifications and Qualifications” concerning the basis upon which it determined the Contract Sum and the Contract Time.

2. This schedule is of critical importance and should be carefully reviewed by the project manager and architect. It creates significant openings for the Contractor to make claims for additional time and compensation.

D. **Allowances.**

1. An “Allowance” is a plug number or placeholder for a portion of the Work for which drawings and specifications are not complete, or which has for any other reason not been bid out at the time that the Contract Sum is established.

2. Owner is responsible for any excess if the actual costs exceed the allowance amount. See A201, Section 3.8.

E. **Cost of the Work.**

1. In a Lump Sum Contract, the Owner pays the lump sum price, whether the Contractor’s actual costs are more or less than the lump sum. In a GMP Contract, however, the Owner pays for the actual Cost of the Work, plus a fee for overhead and profit. As a result, limiting the allowed Cost of the Work in a GMP Contract is important.

2. Section 8.1 of A102 as to “Costs Not To Be Reimbursed” should be modified by expanding the list of exclusions to cover negligence, costs of bonding subcontractor liens, fines and penalties, overtime to achieve schedule.

3. Limiting the Costs of the Work is less critical when the Owner has a high degree of confidence that the GMP is tight.

4. Modify the AIA language to require at least three bids for Subcontracts. (A102 Section 10.1).

5. Tighten the AIA language concerning Owner’s audit rights and include a hold back until the Owner’s audit is complete (A102, Article 11).

6. Specify whether the Contractor may share in “Savings.” Many Owners believe that adding a Savings clause incentivizes the Contractor to keep the Cost of the Work below budget. (See A102, Section 5.2.1)

F. **Change Orders.**
1. A Change Order is a written agreement that increases (or decreases) the Contract Sum, extends (or reduces) the Contract Time, or both. Some owners see Change Orders as a profit center for the Contractor.

2. An Owner may initiate a Change Order, or a Change Order may result from a Claim made by the Contractor.

3. Section 7.2.1 of AIA Document A201 provides that Change Orders must be in writing in order to be effective. Minor change orders not affecting the Contract Sum or the Contract Time may be issued by the Architect. All others require execution by the Owner. However, Owners should be aware that Contractors may claim that a change in the Work was authorized based upon discussions memorialized in minutes of meetings, course of dealing, emails from the Owner’s project representative or otherwise.

4. Consider adding language to avoid such end runs. Sample language is provided in Section 7.5 of the model form of A201.

5. Owners should add language to reduce exposure to Claims that lead to Change Orders.
   - Tighten AIA language that provides that Claims must be made within a prescribed period. See A201, Section 15.1.2 which expressly states that Claims are waived if not made within the prescribed period.
   - Also consider adding language such as A201, Section 15.1.7, which makes each application for payment an estoppel certificate with respect to Claims not then made in writing.

G. Progress Payments

1. AIA A101 and A102 set forth provisions for monthly requisitions. Two key issues to cover are retainage and lien waivers.

2. While there is no set rule, retainage is often set at 5-10% of the amount of the requisition. Common variations include:
   - Reducing retainage after the Work is 50% complete (but be sure to add language such as in A102, Section 12.1.7 entitling Owner to continue to hold previously accrued retainage).
   - Excluding retainage on the Contractor’s fee and so-called “general conditions” expenses.
   - Reducing retainage to some multiple (e.g., 125-200%) of the value of any punch list work at Substantial Completion.
3. Lien waivers should be obtained from the Contractor and all subcontractors (or at least major subcontractors) with each application for payment. Lien waivers may be in a statutory form.

IV. Keeping the Project on Schedule.

A. “Substantial Completion”.

1. Substantial Completion is a critical milestone for purposes of measuring time in a construction contract. Unlike final completion, at Substantial Completion there may be a punch list of items that remain to be complete but that do not materially interfere with beneficial use or occupancy.

2. The date of Substantial Completion relates to numerous provisions of the contract, including:
   - Determining whether the Contractor is liable for liquidated damages or other damages for failure to timely complete the Work. (See A102, Article 4)
   - Starting the commencement of warranty periods. (See A201, Section 12.2.1)
   - Starting the clock for the Contractor, Subcontractors and suppliers to file liens in some states.
   - Trigger reductions in retainage.

B. Liquidated Damages.

1. It is common practice to include a liquidated damages clause, and it may be especially important for non-profit institutional owners, such as universities, where direct damages are difficult to prove. See A102, Section 4.3 for a sample clause.

2. If liquidated damages are to be included, it is important to specify the damages early in the process with the Contractor. It is harder to impose liquidated damages as a contract remedy after the Contractor has solicited bids from subcontractors.

C. Claims for Extensions of Contract Time.

To avoid liquidated or other damages, Contractors will try to make Claims that extend the Substantial Completion Date. See above regarding language to limit the Contractor’s ability to make such claims.

V. Other Key Contract Issues

A. Insurance.
1. It is important to line up third party (lender and landlord) requirements and to involve an insurance adviser early in the negotiation process.

2. Liability insurance coverage includes general liability, worker’s compensation, automobile liability, and excess/umbrella coverage.

3. Property insurance includes builder’s risk.

4. In some circumstances (such as a design/build project), professional liability/errors and omissions coverage may be needed.

5. For large projects, an “Owner Controlled Insurance Program” (“OCIP”) or Contractor Controlled Insurance Program (“CCIP”) may be advisable.

B. Bonds.

1. Owner may desire a payment and performance bond, and the Owner’s lender or landlord may require it.

2. There are various types of bonds (payment bonds, performance bonds, lien bonds) and bonds may be procured by the general contractor or one or more subcontractors.

3. Subguard Insurance may be an alternative to bonding.

C. Termination Rights.

1. The AIA language concerning defaults that trigger termination rights are vague and should be tightened (See A201, Section 14.2).

2. Owner may try for a right to terminate without cause, without being obligated to pay overhead or profit on Work not performed. (See A201, Section 14.4)

D. Assignment.

Owner should try to broaden the AIA language on permitted assignments in A201, Section 13.2.2. The standard form treats lenders as permitted assignees. Add landlords and purchasers as permitted assignees when appropriate.