



Negotiating Design and Construction Contracts

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MARNI CENTOR: Hello, everyone. The Association of Corporate Counsel and SmartPros Legal & Ethics welcome you to today's webcast, "Negotiating Design and Construction Contracts."

[The instructions provided here were intended for attendees of the live webcast when it was originally broadcast.]

Our presentation today will be moderated by Philip Brody. And now, I'll turn it over to Phil.

PHILIP BRODY: Hello. My name is Philip Brody, general counsel, Time Equities, Inc., an international real estate company headquartered in New York City, and chairman for the programming for the [ACC] Real Estate Committee. I would like to welcome everyone to the webcast on key issues in negotiating design and construction contracts.

Our panelists today are Sean Boulger, a senior partner in the real estate department of the Boston office of Wilmer Cutler Pickering Hale and Dorr. Wilmer Hale is the corporate sponsor for the Real Estate Committee. Sean has extensive experience on a wide variety of design and construction projects, including office buildings, hotels, multi-family and senior housing, retail centers and manufacturing facilities. Major projects include One Lincoln Street, High Rise Office Tower, and the Charles Street Jail Hotel in Boston. He also represents numerous corporate clients on tenant improvement projects.

Our other panelist today is Joel Sciascia, who is general counsel for Pavarini McGovern, a construction management company headquartered in New York City. Joel has been the general counsel for Pavarini McGovern for the last eight years. Joel has worked on a variety of construction and development projects, including those for residential, including condominiums, hospitality, commercial office, health care, governmental and higher educational facilities.

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Now I would like to turn the program over to Sean.

SEAN BOULGER: Thank you, Phil. It's a pleasure for me to address the ACC again. Last fall, I made a short presentation on construction contracts to the ACC, and I am pleased to be able to make today's presentation, which will expand our topic to include design contracts as well as some key issues relating to construction contracts and construction management agreements. Before we get into the program, we have a few poll questions that we want to obtain your responses to. So Marni, if you want to cue the poll questions, we'll get a sense of the background of the group before we get into the presentation.

MARNI CENTOR: Sure. Here's our first question: Is your organization planning a construction project in the next 12 months? Please vote. We'll give you all a few seconds to cast your votes.

SEAN BOULGER: This will all count towards job creation for the president's stimulus bill, so we're asking you to say you're doing one even if perhaps you aren't.

MARNI CENTOR: OK, I am going to close the poll in just a few seconds here. Anybody else who wants to vote, please do so now. OK, and here are our results: 77 percent of the audience says yes, and 23 percent say no.

SEAN BOULGER: I hope I didn't influence that by my lame joke about the stimulus bill. Marni, I think the follow-up question regarding the size and scope of the projects.

MARNI CENTOR: Sure. I'm sorry, I have put the wrong question up here now.

PHILIP BRODY: We could do this one in the meantime.

SEAN BOULGER: Well, yes, in the meantime, let's focus on the next question.

MARNI CENTOR: OK, I'm sorry. Which question did you want to?

SEAN BOULGER: The next question would be the number of audience members who have negotiated a design contract.

MARNI CENTOR: OK. I believe I closed that question too quickly, so we did not get very much of the audience voting on that. My apologies.

SEAN BOULGER: Let's proceed to the question regarding management contracts, or construction contracts.

MARNI CENTOR: OK. Here we go, sorry. OK, so how familiar are you with the negotiation of construction contracts or construction management agreements? And please cast your votes now.

OK, and most of our audience has voted. We'll give them just a few more seconds to cast their votes. Closing the poll in three, two, one seconds. And here are their results: 20 percent have never negotiated a contract, 41 percent occasionally negotiate these contracts, and 39 percent frequently negotiate such contracts.

SEAN BOULGER: Great, so a pretty mixed group, and I am going to assume it's probably about the same percentage on the design contracts as well. Did you have the last question, Marni, regarding the size of the projects that the group is working on?

MARNI CENTOR: Yes, here we go. If your organization is planning a construction project, what size project are you planning? Please select one of the answers. And our audience is now voting.

We'll give everyone just a few more seconds to get their votes in. OK, I am going to close the poll now, and show the results. With 67 percent of our audience voting, 22 percent say less than \$1 million, 29 percent say between \$1 million and \$5 million, 32 percent say between \$5 million and \$50 million, and 17 percent say greater than \$50 million, so again, quite a mix there.

SEAN BOULGER: Quite a range, and sounds like some large, sophisticated projects, which is great.

So, let me just set the table for what we would like to get accomplished today. As I mentioned, we previously covered a number of issues regarding construction contracts, and time permitting, we will discuss some of the more important issues on construction contracts as well as construction management agreements. But I want to start by going over important issues from the owner's perspective, with respect to architectural agreements and design agreements.

I am very pleased to have with me on the panel today Joel Sciascia, who, in addition to his experience as a general counsel that Phil mentioned, also lectures on topics involving construction contracts, and will have a lot of interesting insights to add as we go along. Without further ado, I am going to turn to the PowerPoint presentation.

The documents that we are going to talk about today are based on the American Institute of Architects forms. There are a number of groups that publish construction contracts and design contracts. I have found that the AIA is the most commonly used form, and owners and contractors and architects tend to want to use those forms because they're all familiar with the baseline and can focus just on negotiating the key changes.

One of the real advantages of the AIA series is that the design and construction contracts are fully integrated. They are intended to work together, and in addition to the base contracts themselves, there are a number of forms that go along with those documents that are important to any design or construction project, including certificates for acquisition, forms of lien bonds, forms of substantial completion, and a variety of other documents that will come into play, and they all plug in together and work together. And that's really the strong suit.

The documents are available electronically. It used to be that the AIA was just a hard copy of documents and people who negotiated them attached riders with additional provisions, but you can now make the changes right in the body of the document, allowing both sides to quickly see the changes. It does require that you obtain the AIA software and license to use it.

On to the architect's agreement itself, the agreement that we're going to focus our discussion on is the B-101 form of architect's agreement. And that agreement is the AIA's standard form. It comes in two parts. There is an Exhibit A that sets forth the basic project information—the real nuts and bolts of the deal: who the parties are, what the expectations are in terms of a budget and schedule, and a variety of other project-specific information.

One of the more important parts of that Exhibit A is establishing the project team for the project—who is the architect going to assign to the project? And it's much like working with a law firm; in many cases you're not so much hiring the firm as you're hiring a particular attorney and that attorney's team to work on your case or your project, and it's really the same with the architect. And you want to draft language that is going to require the architect to assign specific people and then not reassign them or take them off of the project without the owner's consent.

JOEL SCIASCIA: Sean, just a couple quick points, if I could jump in. Just following up on your prior point regarding the agreements, I've noticed that the AIA documents are a fair middle ground starting point in most instances, as well. Sometimes when you start out with an owner agreement that's done by a boutique law firm, you're starting from an extreme, and it takes a lot more time to get to a fair middle ground, so just another consideration to take in account, with a

positive for using the AIA documents.

SEAN BOULGER: I think that's a good point, and also there are frequently a number of parties other than the owner and the architect or the contractor that need to review those documents. On a project that's financed, the lender is going to want to review them. You may have a situation where your landlord may want to see the documents. And for those folks to start reading a customized agreement, along the lines of what Joel said, is really adding a lot of time and, ultimately, expense and uncertainty to the process. So I think it really is an advantage to use the forms.

On the agreement itself, the architect's liability is really dependent upon whether it performs its services in a negligent manner. And for that reason, it's imperative to establish a standard of care that's going to be observed. This is the place where I see a lot of owners and architects spend an inordinate amount of time. The owner will frequently want the standard of care to be the so-called "highest standard of care available in the industry," to which the architects push back, rightly or wrongly, claiming that that may or may not be an insurable standard, but that it's ultimately unknowable. What is the highest standard? So instead, where I frequently come out, in a reasonable middle ground, is that the standard of care is going to be the level of skill ordinarily provided by architects on projects of similar scope and complexity in the geographic region in which the project is located. That really ties you to a reasonable set of expectations for what the architect is going to provide.

The next slide is insurance, and insurance is, as in any contract, an important area to be covered well, and increasingly complicated. And one of the first things I advise my owner clients do is to make sure that their insurance advisor has reviewed the insurance provisions of the agreement. And in addition to the advisor reviewing them, again, there are other audiences that are often involved, whether that's a lender or a landlord, most commonly, that may also need to review the provisions, or you may need to review the provisions to make sure that the architect agreement provides what those other documents require.

The types of insurance are the standard general liability, auto liability, and workers' compensation insurance, but the architects also need to provide professional liability or errors and omissions insurance. And this is not something that you'd get from a contractor, for example, and it's a different kind of insurance, and most architects, I've found, carry a policy that covers the office and all of its various projects, usually with a limit of \$1 million or maybe \$2 million dollars of coverage. And the problem with that coverage is its available to satisfy claims for any projects that are ongoing at that time, so the architect may present you with a \$1 million policy, but if there was \$1 million claim, or two \$500,000 claims on unrelated projects, when you go to collect on the policy, there may be nothing left. So for that reason, it's important to, one, do some due diligence on the architect and its loss history and maybe get representations from the architect that there are no pending claims. And second, if it's important enough to justify the cost, you might consider buying project-based professional liability insurance, which would just cover claims relating to your project. I rarely see that purchased, because the cost is prohibitive for most projects unless you get into major construction projects in the \$100 million-plus territory, sometimes less, but it's got to be a pretty substantial project to justify the additional premium.

JOEL SCIASCIA: The other point I'd make there, Sean, is to keep your eyes out, if you are involved in a claim with an architect, that most of these policies are eroded for attorneys' fees. So if the litigation goes on for a few years and the architect has all kinds of legal fees, he will be likely eroding away at the \$1 million or \$2 million dollar policy, not leaving a lot of money left at the end of the day to actually pay out a claim.

SEAN BOULGER: Right. I want to talk next about the basic services under the architect's agreement, and the term "basic services" is a defined term in the architect's contract. The architect is going to provide its services typically in five basic phases: schematic design, design to development, construction documentation phase, a bidding or negotiation phase, and then the construction administration. And I'll spin briefly through those five phases.

As they would suggest, it's a progression of design. The schematic design is the earliest phase of design, when the architect is taking a look at the owner's program, made some evaluations of what the owner is trying to get done—what does it need for this space and how much money does it have to spend?—and then put together a very preliminary design that shows what can be done with those constraints. Those documents are provided to the owner, who approves them or modifies them, and once they're settled on what the schematic design documents look like, the architect moves to the next phase, which is design development, a further refinement of the documents and preparation of outline specifications that really start to shape the project.

Once those documents are approved, you head into construction documents, or "CDs," as architects and contractors will refer to them, and those are the detailed drawings and specifications that are going to be used by the contractor to build the project. And during that phase, in addition to the other documents, the architect is helping to prepare bid packages so that when we get to the next phase, which is either putting the project out to bid or working with pre-selected contractor or contractors to negotiate a contract, the architect assists the owner to get through that process of contractor selection.

Once a contractor is selected and the project then moves into the administration of the work, the construction contract gets signed, the construction work begins, and now the architect's services aren't so much design and drawing the building but administering the work of the contractor. One important point to keep in mind is that I mentioned that the documents—the architect's agreement, the construction contract and other documents—are integrated. The architect's responsibilities include responsibility that are laid out in the construction contract. And so, when the owner and the contractor are negotiating that document, they have to be careful not to increase the responsibilities of the architect without getting its sign-off on the documents. I've rarely found that to be a problem, but it is something to keep in mind.

During the course of the construction, the architect is going to visit the site to become familiar with the work as it is moving along, and here's an important point and sort of a point of tension. The architect is really not making exhaustive on-site inspections. The architect likes to think of its job here as observing and becoming familiar, but it's not inspecting. And it's not there all the time unless the owner is willing to pay for it as an additional service, which you might see on a larger job. And so there is a problem in that the owner is sort of expecting that the architect is going to be his eyes on the job, and he can find that he is not getting what he expected if the architect is merely observing.

And Joel, maybe I'll let you comment on what you typically see in terms of hiring a separate owner's rep to do more detailed type of inspection.

JOEL SCIASCIA: Yeah, absolutely. There has definitely been a trend, at least in the New York area, for owners hiring owner's reps. [They do] a little bit more than program management, I would say. [They are] really kind of the eyes and ears, as you said, of the owner, as opposed to giving the architect the additional services. I would also say that this is probably one of the areas where there has historically been a lot of litigation between owners and architects—historically, just a misunderstanding of what the architect's role with regard to supervision is going to be. And I think over the years it's been a watering down by the architects of what their role for supervision is going to be, and you've probably seen an increase of these owner-rep type of service providers—consultants that are now showing up on projects.

SEAN BOULGER: Another point of tension on the contract is that the architect is supposed to interpret and decide disputes that arise during the course of construction between the owner and the contractor, and in theory the architect is supposed to be neutral in making those interpretations. In the general conditions document, the architect is referred to as the initial decision-maker when a claim arises. In practice, and in reality, the architect is being paid by the owner, and it owes a very commonsense allegiance to the owner, and that becomes clear as disputes arise. And Joel, again, you may want to comment on an alternative that you use in these circumstances to avoid this problem. But the owner is going to expect that the architect sees things the owner's way, and the contractor is going to suspect that that's exactly what's happening, and so if there is a real dispute it ultimately doesn't get resolved by the architect.

JOEL SCIASCIA: Yeah, that's exactly been my experience. I guess I would say, if you were going to ask me what my biggest con is of using the AIA documents, it's probably the dispute-resolution provision as one of them. I just don't see this as something that works very well. The claims that I have been in where the architect served as the initial dispute person, if the architect felt that the owner was wrong, rather than telling the owner that he was wrong, the architect would just do nothing, in which case, it's just a waste of time—about 30 or so days under the basic AIA documents—before the next level of dispute resolution kicks in. So I'm a big proponent of a dispute-resolution board—preselected dispute resolution person—that is agreed to by the parties in advance. And that in and of itself saves a great deal of time and aggravation if a dispute develops, as well as, it's been my experience, that parties are more likely to act accordingly if they know that there is an independent third party that is going to be available to hear disputes.

SEAN BOULGER: And that third party's services come at a cost, which is typically split, I think is the way you do it, Joel (right?), between the contractor and the owner.

JOEL SCIASCIA: That's correct. Each party pays for their own legal fees. Generally it's worded in a way that lawyers are kind of just there to facilitate; it's really supposed to be a process that's about the parties. And the cost of the mediator is split by the dispute-resolution board member or members—I often use a one- or two-person panel—and the costs for those people are split. Now again, another advantage of this process is: Rather than litigation, where you may or may not get a judge that's familiar with construction, you are kind of assured that you're hiring the best of the best. The people that hold themselves out are typically vetted by the American Arbitration

Association or otherwise, and they're both agreed to by the parties. So generally, they're lawyers with a construction background, and they're able to understand very complicated delay—current delay—issues, that tend to mystify non-construction professionals.

SEAN BOULGER: Right. Moving on to some of the architect's other responsibilities during the construction administration phase, one of the things that the architect at least assists with, and sometimes more, is reviewing the contractor's requisitions for payment. Those requisitions ultimately may end up with a lender who is financing the project or with a landlord who is providing a tenant improvement allowance, and the architect serves a role in reviewing and putting those applications in process.

Another of the architect's tasks, and a place to spend some time in the contract, is that it's reviewing submittals that the contractor will make during the course of construction. So the contractor may have requests for more information or he may have samples or shop drawings that he wants reviewed, and the contractor is going to want those turned around quickly in order to stay on schedule, and the owner will want the same. So it's advisable to modify the architect's agreement to require, at a minimum, that the architect perform its review in a way that is not going to cause delay, but even better to have an outside number of days for each review, so that there is an objective, bright line by which it is due. Otherwise these can have a tendency to pile up, and the contractor will make a claim that it's been delayed by the architect's delay in turning around its requests, and that may mean a later finish and a defense to a liquidated damages claim, and other such consequences.

During the course of the work the architect is also authorized to make minor changes in the work. There are frequently issues that come up in the field, and the AIA documents provide that so long as the change isn't something that would trigger an adjustment of the price or an extension of the time that's allotted to complete the work, the architect has authority to make those judgments, which is important to keep the project moving forward, but also important that the architect's authority doesn't go beyond that. Otherwise, the owner can find itself liable for claims for additional compensation or additional time.

Moving quickly through other responsibilities, the architect is the party that keeps a record of all the changes in the work and requests for change orders. Those change order logs become important towards the end of the job. It's frequently been my experience that the contractor will have numerous requests for change orders that it submits, and those all get bundled up into a global settlement towards the end of the project as the parties are finishing the work and settling up the final amounts that are due to the contractor. So having an organized list of all the various changes and records of who claimed what is important to those settlement discussions.

The architect also conducts important inspections, including determining when the work is substantially complete, and that's a term that is very important in construction contract parlance and also in loan agreements and leases, and it's the architect who makes that judgment and signs off on it. In the course of doing that, the architect will also approve a punch list of what remains, and that list becomes the sort of schedule of what work the contractor still owes the owner and how much the owner owes the contractor for it.

Those are the sort of basic services. But some other things that are important that are more

nuanced that have to be thought of as basic—or perhaps additional—services, include coordination. The architect is one design professional on the job. Sometimes there are others, and the architect certainly has his own team of professionals whose services it needs to coordinate, and it may have some responsibility to coordinate the services of owner consultants. The owner may separately hire certain professionals. And to avoid a finger-pointing exercise at the end of the job when the design didn't work, it's really important to deputize one party with responsibility for overall coordination of design, to make sure the whole thing fits together.

And Joel, you can comment on this as well, but I have found that when the owner decides to retain its own consultants on the design side, that that is frequently a recipe for trouble because you end up with finger pointing when the pieces don't fit together.

JOEL SCIASCIA: Yeah, Sean, I absolutely agree. I have actually never seen it work. I think the perception is that the owner can save some money by kind of subbing out all this stuff to consultants directly, but I think that what happens is: There is probably some grudge or something that's held by the architect, maybe. I've seen owners try and do it, and it results in a lack of coordination and a lack of willingness when things need to be coordinated or when issues need to be addressed. People just don't seem to act in the fashion that they should be when there isn't one point person.

SEAN BOULGER: I agree completely. Another aspect of coordination, for those of us who might do a project that's an alteration of an existing facility, is coordinating the new work that the architect is doing with the existing conditions, and that's something to be negotiated with the architect. It might be part of the basic fee, or it might be thought of as an additional service.

Green building design, which is a topic beyond the time we have today, is another issue that needs to be covered. There is a significant additional work that may be required in the design in order to meet the so-called LEED levels, so if the owner wants his building to be LEED-certified, it's important to spell out whether that work is part of the fee or whether it's an additional service that the owner can elect at some later point. There is also a distinction between designing to meet LEED certification requirements and actually going through the certification process—two different things, and can be treated differently in the agreement.

So we talked about basic services. Then there are additional services, which is the sort of the architect's equivalent of the change order. And charges for additional services are different than the basic fee, and so it's important to try to avoid disputes over when a service is basic and when it's additional. The AIA, I think, does a pretty reasonable job of that; I've proposed some other language to tighten it up somewhat. Obviously the architect shouldn't be able to perform additional services unless the owner authorizes them in writing. The owner shouldn't get surprised later with a bill unless it's given specific permission to go forward with the service. And also, obviously, if there is an additional service made necessary because the architect or one of its team members made a mistake, that additional work to clean up the mistake can't be treated as an extra.

I like to include some language that says that the basic services are going to be anything that's reasonably inferable from the specifically mentioned basic services, to try to avoid a real strict reading of the agreement. So that the architect can say, "Well, if it's not written in clear language

in the agreement that it's part of basic services, then I am charging an additional service," is really, I think, an unfair way to approach it, and a notion of what's reasonably inferable is appropriate. The AIA has a section that deals with when the architect might make a claim for additional services, and that includes looking at making site visits more than a specified number or viewing more than a specific number of requests for information. It's a place for the owner to be thoughtful and really think about how the project is going to work, and try to build in as much cushion as you can, so that two or three times of having to go out to the site more than you might have expected won't generate an automatic claim for additional services.

The last point I wanted to make on that subject is: If there is a dispute as to whether a service is basic or additional, I like to include language that says that the architect will proceed under protest as the parties resolve that. And Joel, I know you have had some experience with that approach and some practical thoughts on it.

JOEL SCIASCIA: Yeah, I can speak from firsthand experience on that type of a provision as it relates to a construction agreement. And you know, I just don't know that practically, whether that type of language works. It typically doesn't work in a construction format. Most trade subcontractors—trade contractors, I call them—will only go so far with progressing disputed work and then they'll draw a line in the sand, and my general sense is that it's probably a similar way with architects. The experience that I do have with architects is that they just move a lot slower when they feel that their bills aren't getting paid.

And, as you mentioned before, you know, when you're talking about turn around times on RFIs and submittals, it does have the real, practical effect of slowing down the job and then resulting in claims from your contractor or CM. So my suggestion for the owners is to realize that at some point you may have to write a check to keep the project moving, but you should try and find a way, through your lawyer, to keep a reservation of rights so you have the ability to get that money back.

SEAN BOULGER: I think that's good advice. And the next topic I wanted to cover is the cost of the work. The owner has a budget for the work, and the architect is supposed to be designing towards it. And at the end of each of the phases we described—the schematic design, design development, construction document phases—the architect's design is checked against that budget. And if it exceeds the budget, the architect should go back and redesign the project to stay within the budget. Something similar happens at the bidding or negotiation phase, when the drawings actually go out to bid, and now the market is really tested, and if the bids come back and they exceed the budget, then, again, something has to happen. Either the owner has to agree to increase the budget or he's got to rebid the job or maybe scrap the project or, more likely, go back and modify the project so that the budget can be met—so so-called value engineering or other changes to the project. And Joel, here again is an issue where a lot of litigation arises.

JOEL SCIASCIA: Yeah, absolutely.

SEAN BOULGER: You know, probably the number one expectation that an owner has is that the architect is going to design a building that's going to fit its budget, and the architect will say, "Well, you know, I am not an expert on the market. That's not my job. All I can do is use my standard of care [and] apply that standard of care to design the building that I think is going to

meet the budget, but at the end of the day, if it doesn't, I'll revise my drawings to try to fit within your budget. But I am not liable for you having a project that is no longer financially feasible." And what this really leads to is—well, go ahead, Joel.

JOEL SCIASCIA: I think you're right. Historically, this is another area where there has been a lot of misunderstanding about the level of service that an owner is getting from the architect. One thing that I'd recommend is using a CM or contractor at this stage—we call it pre-con, even at an earlier stage—to actually try and go out and get pricing from trade contractors on whatever information is available. And that is probably going to start to give you your most reliable estimate of what the cost of the work is.

SEAN BOULGER: Right. Moving on to the next topic, a frequent fight in architecture agreements is ownership of the drawings. The architect is the author of the drawings and specifications and owns the copyright in them, but the AIA documents give the owner a license to use them. There is language that I strike when representing an owner on this section, which ties the license to the owner having satisfied all of its obligations under the agreement, including prompt payment. And what's likely to happen at some point is that if there is a dispute, there is going to be a fight over money, there is going to be a fight over performance, and meanwhile the architect is, by virtue of this language, holding the drawings hostage and preventing the owner from continuing with the project. So I like to modify that language to say that the license is irrevocable, and if pushed, I'll add language that says that the owner will continue to have the right to use the drawings pending resolution of a dispute, but if a court rules that the owner owes money and then doesn't pay it, then the license is revoked.

[The] next subject on architecture agreements is termination. The architect has a right, of course, to terminate the agreement if the owner doesn't pay. My comment here is to make sure to add in some grace period for the owner because, especially if you are relying on funding from a lender or a landlord, there could be delays and you want to have a sufficient grace period before late interest or termination rights kick in. On the owner's right to terminate, it can suspend the project. If the suspension lasts beyond 90 days, under the AIA documents, then the architect has a right to terminate the agreement, or when it restarts the work to be compensated for its start-up costs.

But the owner also has a right to terminate the agreement without cause on seven days' notice. [This is] an important feature. Sometimes projects die—they can't be financed; you can't get the permits; whatever it is. The owner may need the right to just walk from the project. And in walking from it, the AIA agreement says that the owner will pay the architect for all its termination expenses, but will also pay on profit for services that weren't performed because of the early termination. That provision, when representing an owner, should always be struck, and I have met with little resistance from architects on that point. They recognize that in that situation, everyone has probably lost something, and I haven't found they fight very hard on that.

In terms of financing issues, architect's agreements are going to be collaterally assigned to a lender on a construction loan. There is language that allows that in the agreement. But the language may need to be modified, depending on the lender you're dealing with. Some lenders won't accept responsibility for outstanding charges that may have accrued under the architect's agreement, particularly if the project has failed and the lender is taking over in a distressed

situation.

Compensation for the architect: It can be in the form of either a stipulated or lump sum, or it might be a percentage of cost of construction, or it might be based on hourly rates. I find that compensation as a lump sum is most common. Basing it on a percentage of cost or hourly rates really doesn't line up the interests correctly, and to take an extreme example, switching from one finish on the floor to a much more expensive finish on the floor increases construction costs, but it doesn't really increase the architect's responsibility, so there is no good reason to me that the fee should increase. And fixing it on a lump sum avoids those sorts of misalignments.

Compensation for additional services: It's based on an hourly rate, usually, for the architect's own services, and if the architect has consultants, it will pass through those costs with a markup, which I find to be typically 5 to 15 percent. One provision you may try to modify is to fix the hourly rates that the architect and its consultants can charge for some period of time so that there won't be a rate increase during the course of your job.

On the payment for the basic fee, when it's based on a stipulated sum or a percentage, it's paid in accordance with the progress of design across the five phases. And this is a place for the owner to watch to make sure that the fees aren't being frontloaded and leaving not enough for construction administration at the end of the job.

Reimbursable expenses are above and beyond the architect's basic services fee. Sometimes I see owners have a separate sort of upset number, or not-to-exceed number, for reimbursable expenses, but usually it's a reasonably small percentage of the cost of the project. And what I instead see is owners try to limit the categories of expenses that could be passed through. So whether it's computer design time or cell phone charges or transportation, etc., try to knock out some of the smaller charges that the architect might try to pass through.

And that's sort of the main points of the architect's agreement that I wanted to cover. We have a little bit of time left, and we wanted to, particularly while I have the benefit of Joel's involvement on the panel, to talk about some important issues in construction contracts. And, in particular, I wanted to quickly touch on the construction management format, which we didn't talk about in the fall, and then go to some specific issues.

Construction management is a different form or a different way of approaching a project. In a typical construction contract, the contractor is hired at the end of that bidding or negotiation phase under the architect's agreement, when the drawings have been completed and the work is ready to begin. In a construction management format, which is now the AIA document A133, the construction manager is involved in the pre-construction phase. So they are shoulder to shoulder with the design team and the owner in the beginning of the project, and able to assist the owner and the architect on value engineering, on budgeting, cost estimating, ordering long lead-time items. And Joel, I think that you'd agree that this is a format that is growing in popularity.

JOEL SCIASCIA: Yeah, absolutely. Certainly those people that took the poll who are doing some of the larger projects, one of the benefits is being able to get started with construction sooner—going with construction of the foundation while the interiors are still being decided is a relatively simple example of one of the benefits of a construction management approach. We

also talked a little bit about some of the early involvement benefits that come out of pre-construction, where your contractor and construction manager [are] shoulder to shoulder with the architect, as you say, and able to give the architect feedback on a very regular basis as to issues with the drawings that might be a problem from a constructability standpoint or cost issues that may be coming up.

SEAN BOULGER: OK. We're going to cover just a couple of last points and then maybe turn to some questions. One of the issues, Joel, that I wanted to get your take on was liquidated damages, which, in a construction contract, it's very common to add liquidated damages as a remedy for the owner if the project is not completed on time. And the liquidated damages are intended to approximate the owner's, obviously, his actual damages from the delay. But Joel, as you and I were discussing in preparing for the presentation, there seems to be a misunderstanding between owners and contractors as to what exactly the liquidated damages cover and whether they're a good thing or a bad thing from each party's perspective. Maybe you could comment on that.

JOEL SCIASCIA: Yeah, certainly. I mean, I think you make a great point on your slide. Liquidated damages, I think, are key for an owner that is going to have actual damages that are going to be really hard to prove. [For] a university [or] a not-for-profit, I think ultimately if the contractor is late, it's going to be very difficult to show actual damages. You should think about liquidated damages. The other benefit of liquidated damages from both parties' perspective is that you don't have to fight about what the damages are going to be. So that is definitely a big advantage because it could be very costly—more than the value of the actual costs—the money spent litigating over what those actual costs are.

The confusion seems to become—and I see it on both sides, contractors and owners—contractors that say, “Oh, my God, no way am I taking liquidated damages,” and as a construction manager, you're just sitting there holding your forehead, because you're thinking to yourself, “My God, this is a hotel. The owner's damages here are going to be staggering if you're late. He's telling you he's going to cap the damages at \$300,000.” Now, it's a win. So you definitely deal with that issue on the contractor's side, and I actually deal with owners that don't seem to understand the other side of that, which is that your damages are going to be capped. You're not going to be entitled to your actual damages if you agree to a liquidated damages provision.

SEAN BOULGER: Right. And it can really be, as you say, a great advantage to a contractor who may not appreciate that this is protecting it from a catastrophic claim.

Another topic that I wanted to cover under construction contracts is holes in the GMP. Owners frequently get a guaranteed maximum price contract, and they feel that the guaranteed maximum price is it, and will not be exceeded, and they can rely on that, but in fact there are many places in a contract that there are either ambiguities or places for interpretation that lead the contractor to make a claim for additional compensation. So there can be miscoordination or inconsistent documentation. In the AIA documents, one of the changes that I recommend is that the parties establish an order of priority among the documents, so that if there are inconsistencies, at least there's a ranking system. And then, within any document, if there is any inconsistency, the higher quantity or greater quantity would prevail if there is a conflict. But a further change that I like to make—and I'd like Joel's thoughts on this—are to add that, as in the architecture

agreement, that the work is going to include anything that's reasonably inferable from the drawings and specifications. And Joel, I think you've had experience negotiating this kind of clause. Maybe you could give some perspective on that.

JOEL SCIASCIA: Yeah, I mean, I think that's a reasonable position from both an owner and a contractor standpoint. The AIA uses that language. I don't know if they are the ones who originally authored it, but it certainly is prevalent in their construction series documents that the contractor is responsible for performance of the work, including anything that's reasonably inferable from the plans and specifications. I tend to see these boutique law firms, that when they come out with their out-of-the-box contract, they take it up a notch and they start talking about anything that is necessary, not just reasonably inferable, and I think that's where you kind of have to draw the line from a contractor's standpoint, and from an owner's standpoint, realizing that you're hiring a contractor, not a designer. So, I think the "reasonably inferable" is a good standard.

Getting back to your point about the exclusions and the order of precedence, it is interesting that you brought up both of those points together, because what you'll find is that on a fast-track process the GMP is going to be provided after the construction management is executed. And that's certainly the format of the 133 and its predecessor, the 121. And what happens is: The GMP comes in as an amendment to the overall contract. Part of that GMP is exclusions and qualifications. And it's essentially a scope document—what the contractor, or what your construction manager is not going to be providing—and that is something that has to be reviewed in great detail. A lot of times, there are things in there that maybe the owner, on first blush, thinks that he was getting, but that he isn't. So it's something where a good deal of dispute is going to arise if the parties aren't aware of what's included there.

SEAN BOULGER: Right. Well, we could continue on. I covered a lot of this ground in the session that we conducted in the fall. And we have just a minute or two left, so I wanted to turn to at least a question or two that had come in, which I will read.

This is going back to the architect's agreement. And the question is: What can the owner do to protect himself from liability if LEED requirements are not met? For example, a government contract might require LEED Silver certification. If that certification is not obtained, the owner may lose a significant amount of money.

And you know, I think that—and Joel, I'll be interested in your take on this as well—in the architect's agreement, we talked about a negligence standard, but I think there are also standards that are more objectively described, and if the design was to be to the LEED Silver certification standard and it wasn't satisfied, I think you certainly have a claim against the architect for failure to meet that standard.

One of the issues, always, in dealing with the architects is your ability to recover damages from the architect even if you have a good claim. We started by describing that architects carry rather low coverage on their insurance. Might be \$1 million or \$2 million of professional liability insurance. The architectural firm itself is apt to be a service corporation that doesn't have significant assets, so what you're really going after with that claim is the insurance policy and perhaps other assets that the architect has, but as I said, for the most part it's receivables in and

payables out, and not a lot of assets on the balance sheet. And if that insurance is exhausted, either through defense costs or through other claims, at the end of the day, you have a hard time recovering, even if there is a good claim. And for that reason, on a project that merits it, where there is high risk and lots of money involved, considering project-specific insurance is appropriate. So I don't know if you have any other thoughts on that question.

JOEL SCIASCIA: Yeah, I absolutely agree. If you're talking about a large amount of financing being lost, I would probably advise a client to look into some type of insurance that would be able to cover that. Relying on a design professional's PL is probably not going to be the answer. The other thing, assuming it's not a catastrophic thing, as loss of financing, one thing to consider is something more incentive-based, [for example,] giving your design professional, as part of his compensation, a block of money related to getting that certification or some type of a retainer that's held from his fee until that certification is obtained.

SEAN BOULGER: I think that makes sense. Another question that's come in—I think this will be our last question, Marni. Let's see if I have the whole thing. In a cost-reimbursable—the comment relates to the A102, and that in a lump sum contract, the contractor will factor in some contingency for costs to correct defective work, whether it becomes apparent during the course of the work or during the warranty period. And in a cost-reimbursable case such as a 102 there is no such contingency. Please comment on whether you feel the risk allocation made by paragraph 773 and 815 is appropriate and makes sense. For example, won't the owner always argue that any defective work was the result of negligence by the contractor? Are there other, perhaps more creative, ways to address this issue in a cost-plus contract?

I think the standard AIA approach is that if there was work that needs to be re-performed, even if it results from negligence, that so long as the guaranteed maximum price is not exceeded, the owner got the benefit of its bargain. So if a subcontractor did the work incorrectly and the contractor has to re-perform it, so long as at the end of the day the owner doesn't pay any more than the GMP, the owner got what it bargained for.

I've been involved in many negotiations where the owner tries to take the position that is taken in this question, which is any negligent work belongs as an expense of the contractor and is not reimbursable, and therefore the owner doesn't have to pay. Sometimes the owners have prevailed in that case, but I would say, more often than not, the ultimate answer is that the GMP is the owner's protection. Joel, I don't know if, again, you have any thoughts on that?

JOEL SCIASCIA: Absolutely, it is a great question. I am involved with some stuff that is not going that way, where the owner, to try and protect himself in a cost-plus scenario, has taken a position that, "You know what? In order to extract some settlement money, I'll bring the CM into this, even though I don't have a GMP, to try and offset some of the claims, because you know what? It's negligent supervision on the part of the CM."

So, I think it's a great question, and the creative answer is that—[and] I don't get much resistance to it on an open-book contract—is that there should be a contingency inside of the GMP that the contractor can use to deal with those types of issues, even on a bonded job, even when the trade contractors are providing bonds. A sophisticated owner should realize that it's not worth it, in most instances, for even a few hundred thousand dollars, to try and litigate against a

bonding company, if it's a relatively large project and the funds should be there to be able to deal with those types of issues.

SEAN BOULGER: OK, well, I think we've exceeded our time by just a couple of minutes, and I am sorry for that. But I think that concludes our presentation.

PHILIP BRODY: I would like to thank our panelists, Sean Boulger and Joel Sciascia, for an outstanding presentation. Please don't forget to complete the evaluation form when you exit the webcast. This and other ACC webcasts have been recorded and are available for one year after the presentation date. Go to webcasts.acc.com. Thank you for attending this webcast on key issues in negotiating design and construction contracts—an outstanding job by our panelists.

SEAN BOULGER: Thank you very much, Phil.

MARNI CENTOR: Thanks, Phil. I'd also just like to let the audience know that although we were not able to get to all of the questions today, the speakers will receive all of those questions and may be able to address some of them after the fact.

SEAN BOULGER: Absolutely.

MARNI CENTOR: On behalf of the Association of Corporate Counsel and SmartPros Legal & Ethics, thank you again for listening to today's program, and have a good day.