Contract Killer Clauses in Construction: How to Neutralize Them?

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Average annual growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Manufacturing</th>
<th>Total Economy</th>
<th>Construction</th>
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<tbody>
<tr>
<td>1995</td>
<td>100%</td>
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<td>1997</td>
<td>102.8%</td>
<td>102.8%</td>
<td>102.8%</td>
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<td>1999</td>
<td>105.6%</td>
<td>105.6%</td>
<td>105.6%</td>
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<tr>
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<td>108.4%</td>
<td>108.4%</td>
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<td>2003</td>
<td>111.2%</td>
<td>111.2%</td>
<td>111.2%</td>
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<tr>
<td>2005</td>
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<td>114.0%</td>
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<tr>
<td>2007</td>
<td>116.8%</td>
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<tr>
<td>2009</td>
<td>119.6%</td>
<td>119.6%</td>
<td>119.6%</td>
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<tr>
<td>2011</td>
<td>122.4%</td>
<td>122.4%</td>
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<tr>
<td>2013</td>
<td>125.2%</td>
<td>125.2%</td>
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<tr>
<td>2014</td>
<td>128.0%</td>
<td>128.0%</td>
<td>128.0%</td>
</tr>
</tbody>
</table>

Productivity: Real (2005 $) gross value added per hour worked by persons engaged (indexed, 1995 = 100)

Source: McKinsey Global Institute analysis
What Poor Contract Forms Can Do to Project Results

• **5 EXCULPATORY CLAUSES INCREASES PRICE 8-20%**
  • Site Conditions
  • Delays
  • Liquidated Damages
  • Indemnification
  • Sufficiency of Contract Docs

• **Construction Industry Institute (CII) Study on Risk Allocation**
  • Unnecessary Risk Contingencies
  • Best Contractors Seek the Best Owners
  • Worst contracts get worse results.
Typical Construction Contracts

• **Biased and Unfair** - standard contracts written by one association are perceived to protect that group

• Modifications exceed the original “standard form”

• Parties push risk instead of managing or mitigating risk
Einstein’s Rule for Construction Contracts

“...the definition of INSANITY is doing the same thing, over and over again, and expecting different results.”
Contracts Negotiation Strategy

- Contracts should memorialize a business relationship (not declare war)

- Win-Win vs Win-Lose

- A bad project is usually a failure for all.
The ConsensusDocs Coalition
40 Construction Industry Associations
ConsensusDocs 11+ Years

1 Goal
Improve the design and construction industry with best practice contracts that are fair to all parties.

11
Years in business.

100+
Standard contract documents.

40
Leading construction associations participating in the Coalition.

3,000+
Subscribers.

$1,000,000+
In donated free educational licenses.

$40+ Billion in construction contracts

NO Reported Litigated CASES
First Step to Spot the Killer Clause

RTFC
Scope of the Work- Killer Clause

• The Contract Documents include all items necessary for proper execution and completion and what is **reasonably inferable** from the Contract Documents to be necessary to produce the “**intended results**”

• Beware of language negating Spearin Doctrine through study and compare obligations!

• Contractor should report discrepancies before work begins.
Strategy on Scope of the Work

• “Intended Results” turn Builders into mind-readers

• Design intent should be based on what is indicated in the contract documents
  • Most builders report inadequate design documents, and its getting worse

• Builders are not paid to be inspector

• Include Order of Precedence clause.
What is Reasonably Inferable?

• NOT “Reasonably Inferable” – look at the materiality of the change
  • If omitted from the Plans and Specifications, and results in a material additional cost
    • If omitted from only one, then harder to say not inferable
• If any additional design work is required
• If any Submittal is required and such Submittal was not specified in the required Submittals
• If the work requires material changes to sequencing or scheduling.
# Set an Order of Precedence

## Rather than Litigate Conflicting Docs

**ConsensusDocs**

- Provides an order for interpreting conflicting contract documents
- Avoids unneeded litigation costs
- Most recent contract documents govern
- Change Orders = highest precedence.

**AIA**

- Modified Golden Rule. He who has the gold, makes the rules.
Killer Clause -- Differing Site Condition

Contractor represents that it has inspected the Project Site and has satisfied itself as to the condition thereof and that the Guaranteed Maximum Price is sufficient to cover all the Work, including all foreseen and unforeseen risks, hazards, and difficulties in connection therewith, including without limitation, any concealed or subsurface conditions at variance with the conditions indicated by the Contract Documents or other documents furnished Contractor for its information.

The services, information, surveys, and reports to be furnished by other consultants employed by Owner, shall be furnished with reasonable promptness at Owner’s expense and Contractor shall verify the accuracy and completeness thereof.
Killer Differing Site Condition Clause

Transfers unknown site conditions risk to the Builder from Owner

- Obligation to study and compare Contract Documents
- Failure to discover error transfers obligation of Constructor to Correct the Work at its expense – Constructor becomes an uncompensated inspector
- Obligation to take field measurements and verify field conditions
- Review soils + geotechnical reports + any other Owner docs given, even if disclaimed for reliance.
Mitigation Strategies

• Look to standard construction contracts or Fed Gov. Regs. (FAR, DFAR)

• Don’t be afraid to negotiate

• Facts matter

• Precon work (field tests) may increase liability.
Killer Clause:
NO DAMAGES FOR DELAY

Examples of No Damages for Delay Killer Clause:

- Upstream party’s fault for Delay, but you only get time, NO MONEY

- Unreasonably short time req. to seek change for time or ability to $ compensation is waived.

- Variation: if not limited to time extension, then limit to direct costs and increased general conditions
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Delay Claims Strategy

- Does State Law Prohibitions?
- Notice Reqs – Delay may arise much later than actual change
  - Claim only barred if Owner can show actual prejudice
  - Claim permitted if Owner had actual or constructive notice
  - Alternative: phased notice
    - notice of delay
    - doc supporting $ or time claim later

- Does the Subcontractors flow down provision adequate time for pass through claim?
**Killer Indemnification Clauses**

- Broad form indemnity, indemnify party even if they are solely at fault
- Variation: concurrent negligence up to 99% fault
- Include an obligation to defend
- Broad definition of claims to be indemnified
- Need indemnified party’s consent to settle.
Strategies Out of Killer Indemnification Clauses

• Limit to your negligence percentage of fault or intentional acts
• Limit to your acts – only those you contract with or your insurance covers
• Limit to third-party bodily injury and property damage
• Establish right to defend, but not duty to defend
• Confirm state law on indemnification – e.g. Fla. Stat. 725.06 requires specific consideration for indemnification in construction contracts
Killer Clause - Change Orders

• If no agreement, Owner orders Constructor to perform work as a Interim Directive (or CCD in AIA terms)

• Builder becomes a banker b/c forced to fund labor and materials in dispute
How to Neutralize Change Order Clauses

- ConsensusDocs requires for 50% of disputes amounts of work NOT in dispute
  - (100% of undisputed #)

- Limit % of interim directive change to contract before agreement
  - Over a percentage value of the contract sum = special provisions:
  - Additive changes over 25% - cardinal change to the Contract
  - Deductive changes over 25% - Contractor still receives overhead and profit despite reduced Scope of Work

- Include Cost of the Work details in lump sum contracts for clarity on changes
Killer Payment Clauses -- Retainage

• Retainage is typical, but if excessive = killer
• What is the purpose of retainage?
  • Match work and payment, not a project funding source
• Strategies: Reduce at 50% completion of Work
• No retainage after Substantial completion except for punch list items.
Killer Clause – Withholding Payment

• Withholding for:
  • anticipatory breach
  • projected failure of not meeting GMP
  • Projected not hitting Substantial Completion date.
Killer Clause -- Consequential Damages & Liquidated Damages

Making Constructor responsible for all consequential indirect damages is a killer.

Conseq. damages include:
- Lost of income and profits
- Owner's loss of use of the Project
- Rental expenses
- Project financing
- Insolvency
- Reputation

LDs can be killer, esp. if they are a penalty (unenforceable?).
Strategies Out of Killer Conseq. Damages Clause

- Look to standard contracts: ConsensusDocs and AIA
- Specify Conseq. Damages not waived
- Specify pricing / methodology
- Negotiate LDs and limit exposure to consequential damages
- Explain that pain should incentive acceleration not insolvency.
Thou Shall Incentivize Positive Performance

Pair Liquidated Damages = Incentives

6.7 AWARD INCENTIVE. The maximum amount of incentive shall be _______. To receive an incentive award based upon early completion, the Constructor must provide the Owner a written notice of its intent to achieve completion early no later than 60 days prior to the contract date of Substantial Completion. If achieved, the Contract Price shall be adjusted by Change Order to reflect the Constructor's incentive award. Incentive award payment will be made upon receipt of a proper application for final payment after execution of that Change Order. “

Example of ConsensusDocs Incentives language in the Guidebook:
Communication

• Endeavor to ONLY communicate through the Architect (see 2007AIA A201 §4.2.4).

• Another killer clause - Require all design related claims need to be certified by another licensed design profession.
Killer Clause -- Design Delegation

• Delegated design responsibility for a project (not design-build) without specific design criteria is problematic.

• The larger the element of design the more problematic.

• Creating fiduciary responsibility is a killer clause.
  – See AIA design-build documents.

• Does the architect of record have design coordination responsibilities or does the builder warrant a “perfect” design that Owner and architect may fully rely upon.
Design Delegation -- Strategies

• Delegated design reqs. should be clear in an exhibit not hidden in performance specs)

• “Approval” by the designer of record should be clear without “weasel words”

• Require coordination by the designer of record (ConsensusDocs does vs AIA A201 does not)

• Don’t warrant a perfect design.
• Design Professional must provide construction documents that provide all necessary info to **bid and build** the project

• Better language for Owners to renovate or not let their project be held up for any and all dispute with A/E.
ConsensusDocs Project Financing Info

• Failure to provide info = Stop Work

• CD 290 and 290.1 financial questionnaire

• Beware of confusing standards to be able to request info
Top Advantages with ConsensusDocs Contracts

- **Active Owner** vs passive + A/E authority matches responsibility
- Direct and **positive communications** rather than contractual silos
- **Clearly written** w/ integrated general conditions vs. legalese
- Track record = less reported case law + better project results
  - Fair works (get best contractors at their best prices)
- Best practices and industry firsts
  - IPD, IPD’ish, BIM, Lean, Design-Assist, Green, project financial
- Updated more often than once per decade.

ConsensusDocs® BUILDING A BETTER WAY
Proven Results for St of Iowa
Iowa DAS’ using AIA vs ConsensusDocs

<table>
<thead>
<tr>
<th>Using AIA</th>
<th>Using CDs</th>
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</thead>
<tbody>
<tr>
<td>68 project/year</td>
<td>98 projects/year</td>
</tr>
<tr>
<td>$40M/year</td>
<td>$80M/year</td>
</tr>
<tr>
<td>Claim/s on EVERY PROJECT</td>
<td>NO Formal CLAIMS on over $400M in construction</td>
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Outlook

Coming Soon
• Master Subcontract
• P3
100+ Contracts

• 200 Series – General Contracting
• 300 Series – Collaborative
• 400 Series – Design-Build
• 500 Series – Construction Management
• 700 Series – Subcontracting
• 800 Series – Program Management
• 900 Series – P3

ConsensusDocs
CONTRACTS CATALOG

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How Fair Construction Contracts Build Success

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