CONSTRUCTION CONTRACT DOCUMENTS AND PROJECT MANAGEMENT

By: Daniel Goodwin and Roger Fitzgibbon

Whether designing and constructing a new retail center, a tenant finish out or a renovation project, retail real estate developers, property managers and tenants interact with construction contracts, contractors, architects and other construction industry professionals on a regular basis. Those interactions may include lengthy, sophisticated contracts, very basic contracts or no written contract at all. Regardless, there are certain issues that could arise in almost any construction project. This article will address some of these common issues from the perspective of protecting the owner of the project.

What Is The Industry Standard Contract?

While various industry groups have developed their own versions of standard contracts, there is no universally accepted form of construction contract. The American Institute of Architects actively promotes its form contract documents. These documents are commonly known as “AIA documents,” and are denoted by various numbered and dated versions. These different versions are geared towards different construction situations. They include fixed price contracts, “cost plus” contracts, contracts that are relatively small and simple, as well as those that are multi-phased and extremely complex. These form documents have been in use by the construction industry in various revised versions since 1915. Most contractors and architects are familiar with the AIA form documents to some degree. However, an owner should not rely on the architect or contractor alone to interpret the contract. Even architects sometimes assume that similar provisions are the same in all AIA documents, when in fact, the provisions may have been changed in a newer version or by the contractor and owner. Modification of these and any
The form contract document is certainly not unusual, and often may be necessary in order to meet financing or other project-specific requirements.

The AIA documents also includes form agreements between the architect and the owner. The parties should determine in advance whether the architect will administer the contract through construction or whether his services will stop after design. In many cases, utilizing the architect for these contract administration services (reviewing and certifying applications for advance and making the initial decisions on disputes between the parties) can reduce friction and confusion. At the same time, it can sometimes slow down administrative tasks and increase costs.

**Basic Steps to Protecting the Owner’s Interest.**

Each party should consider whether to insert their own specific provisions in a contract as superseding general conditions. While there is no substitute for reading and understanding the proposed construction contract, a party’s own superseding general conditions or addenda can certainly add a degree of security and predictability. Important provisions to address can include the right to assign the contract to the construction lender, changes in the work, retainage, pay request requirements, indemnification for mechanic’s and materialmen's liens, construction scheduling, notice as well as payment and performance bonds. An addendum addressing these issues can be attached to the form contract and the parties can agree that it will control over any conflicting provision of the master contract.

The paperwork should not end with the execution of the contract documents. It is critical for each party to document their position throughout the construction process. This documentation may take the form of correspondence or memoranda, as well as change orders and other mutually agreed modifications to the contract. Project management documentation
serve two purposes: 1) they leads to better communication between the parties, and 2) they create evidence supporting the owner’s position, should disputes later arise. Owners should remember that most construction contracts do, or should, contain a right for the owner to inspect and copy all records and documents relating to the construction of the project, including all construction logs, invoices and subcontracts. If the owner believes it may have a claim, review of these documents should enable the owner to substantiate it.

**Key Contract Clauses.**

While not exhaustive, the following important topics appear in most construction contracts.

**Incorporation By Reference.**

Most construction contracts consist of more than a single “contract” document. More often than not, the construction contract will, by definition, include plans, specifications, award, notice to proceed, contract/agreement, general conditions, and supplemental general conditions. An incorporation by reference clause makes all or part of some other document part of the primary construction contract. The contract between the developer/owner and general contractor, normally incorporates by reference the drawings, specifications, agreement, bid award, notice to proceed, payment and performance bond, agreement, general conditions, and supplemental general conditions. It may also incorporate other addenda issued prior to and modifications issued after execution. The owner must obtain and review all incorporated documents in advance of executing the actual construction contract.

Disputes can arise over the sufficiency of, and compliance with, the plans and specifications. Sometimes the dispute may be whether the standard of “workmanlike manner” is modified by plans, specifications and the like. It is crucial to itemize the plans and specifications
and other documents to be incorporated in the contract. Moreover, the parties should clearly delineate the order of priority of each of these items (for example, do the plans supersede the written specifications, or whether the general conditions are superseded by the supplemental conditions in whole or in part).

**Conduit Clause.**

As a result of multiple separate contracts, a special problem arises in the construction context with respect to the “flow-up” and the “flow-down” provisions. These provisions are sometimes called conduit clauses as they seek to pass the rights and obligations held by one party to a third party under a separate contract. A conduit clause effectively requires that the lower tier entity, whether subcontractor or materialman, know what is in the prime contract. The prime contract doubtless will incorporate plans, specifications, general and supplementary conditions, and other documents.

**Right To Stop Work.**

If a contractor is not paid or is faced with some other unforeseen conditions or proposed changes in the scope of the work, a work suspension or stoppage may occur. Resort to termination or work stoppage is the last thing any party should want and should occur only when dictated by economic necessity. Suspension of the work or termination of the contract usually costs everyone but can be catastrophic for the owner as either event is likely a default under the construction loan agreement. Furthermore, remobilization after a suspension or engaging a new contractor after termination usually leads to materially, perhaps prohibitively, higher costs.

A suspension of the work for a breach by the contractor gives the owner leverage to require the contractor to correct construction defects. Such a work stoppage, if justified, would not give rise to the contractor’s right to a change order extending time for completion, and it will
also stop the flow of progress payments to the contractor. If engaged for contract administration, the architect and his determination regarding the necessity of corrections in the work is critical. An initial determination by the architect regarding construction defects that justify a suspension shifts much of the burden from the owner to the contractor in any subsequent mediation or arbitration.

Conversely, an owner must not give the contractor cause for a termination or suspension. This can occur for non-payment, lengthy suspensions of the work caused by owner misconduct or the failure of the owner to provide reasonable cooperation or reasonable assurances of its ability to meet its financial obligations. Consider a situation in which the parties have signed a cost-plus contract with a guaranteed maximum price. While the owner may have concerns about the project, it should avoid suspending the work or failing to make payments certified by the architect. Doing so may create a right for the contractor to terminate the project and potentially any breach or mistake by the contractor (i.e. costs over the guaranteed maximum price) may not become an issue because the termination could excuse the contractor’s obligation to complete the project on budget and on time.

**Payment.**

The owner must be aware of the payment provisions outlined in whatever contract is executed. Specifically, who will be responsible for approval, the timing for such approval, and events of default surrounding the time for payment? For example: when must the pay request be submitted? What is the turn around time for payment? Must the pay request be accompanied by waivers and releases of liens (contractor, subcontractor and all material suppliers)? Must it be accompanied by any other documentation such as invoices or payment receipts from prior pay
requests? All of these issues may be important in managing the contractor’s, subcontractor’s and owner’s project cash flow.

Payment may also be governed by a disbursement agreement prepared and drafted by the construction lender. This would typically involve three parties to an agreement (owner/developer, contractor, and disbursement agent, which could very often be the construction lender). The disbursement agreement should always address the type of account in which the funds are to be held (whether that be interest bearing or not) and who should get the benefit of any interest accruing during construction, and in what way. The disbursement agreement should also address, and more often than not, include a copy of pay request forms acceptable to the disbursement agent. The pay request form may also double as an affidavit of payment of all material suppliers and subcontractors, and as a lien release and waiver. Additionally, it is important that the disbursement agreement clearly and unambiguously state that its terms supersede any other relevant terms regarding payment in any other construction contract document.

**Change Orders.**

Changes in the scope of work under a construction contract are a common and important issue. Generally speaking, most standard agreements require that a written agreement be executed prior to commencement of new work, when a change in that work will increase the contract time or the contract price. A change order may require the approval of the lender, owner/developer, architect, contractor and subcontractor.

Changes in the work and claims for additional payment commonly lead to disputes. Strict adherence to the change order process is important and failure to do so can expose the owner and potentially the construction lender to liability for claims for additional work, which
were not approved by owner. Accordingly, oral change orders are strictly taboo and payment for work that should be the subject of a change order should not be made until the change order process has been completed.

**Changes In Condition.**

In any project involving any type of significant subsurface work, such as excavation, pipeline installation, or the like, the contract should address the risk of changes in condition. Usually the contractor is not relieved of its duties under the contract as a result of unforeseen circumstances, such as pervasive rock formations, which may be expensive or time consuming to remove. So long as the performance of the contract remains possible, performance is still required. Without an agreement otherwise, increased cost of performance is not a valid ground for the rescission of a contract or for a claim for increased compensation.

However, some circumstances may arise under which the duty to perform is discharged or the parties may agree to additional compensation for the contractor to complete the required work. It is not at all uncommon for the construction contract to state that the contractor must represent that he has visited the site, familiarized himself with the conditions under which the work is to be performed, and correlated his observations with the requirements of the contract. This approach is designed to limit the contractor’s ability to make a claim for additional compensation should unexpected conditions be found. However, a claim may still be made if the changed conditions could not have been discovered through a reasonable site inspection.

**Liquidated Damages and Incentives.**

It is quite common for commercial construction contracts to contain liquidated damage clauses which provide that a contractor is required to pay a predetermined amount for each day of delay until the work is completed or accepted. Conversely, there may be incentives for a
contractor to complete the project early or under budget. Cost-plus guaranteed maximum price contracts often provide that every dollar of savings below the maximum price will be shared by the contractor and the owner at a negotiated rate.

Conclusion

Most construction projects are complicated and the contracts that govern them are too. While a thorough analysis of the most common industry standard contracts is beyond the scope of this article, the issues discussed herein should be present in virtually every contract and an owner must have a keen understanding of how the contract addresses them. Developing a set of superseding general conditions that the owner is familiar and comfortable with can go a long way towards minimizing the risk of mistakes and confusion when administering a complicated construction project.

Daniel Goodwin and Roger Fitzgibbon are a shareholders and directors of Gill Ragon Owen, P.A., in Little Rock, Arkansas. Mr. Fitzgibbon a member of the firm’s Construction and Commercial Litigation Practice Groups and Mr. Goodwin is a member of the firm’s Real Estate and Finance Practice Groups. Mr. Fitzgibbon can be reached at Fitzgibbon@Gill-law.com and Mr. Goodwin can be reached at Goodwin@Gill-law.com.