THE INCOMPLETE OR ABANDONED CONSTRUCTION PROJECT

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INTRODUCTION

Depending on the nature and size of a construction project, and the form documents that are used, the construction contract between the owner and the general contractor may be relatively brief, or it may consist of more than 100 pages of fine print and boilerplate designed to deal with every conceivable contingency on a construction project. It is critical for construction owners and their representatives to evaluate each construction contract on its merits, and identify those areas where special or unique provisions are needed.

Nonetheless, there are several key provisions in every construction contract that so fundamentally touch on the risks and liabilities of owners that they must be addressed with respect to each and every project. The following outline is designed to walk the construction owner through these provisions, some of the reasons why these clauses are no critical, and some suggested language to include in each provision.

THE BUSINESS TERMS OF THE CONSTRUCTION CONTRACT: SCOPE OF THE WORK AND COMPLETION DATES

Many owners and contractors alike view the "business" terms (contract amount, completion dates, etc.) of a construction contract as a "fill in the blank" process that can be handled by administrative staff. Experience has taught us that this process is often fraught with complex drafting issues that challenge the most experienced draftsman or attorney. The business terms of any contract, including a construction contract, should be treated with great care and precision in order to avoid misunderstandings, unnecessary litigation and unwanted liability. After all, the scope of the contractor's obligation, and the amount it is to be paid for that work, are part and parcel of every construction dispute.

A. Scope of the Work

The description of the work to be performed by the contractor is critical. It must be clear, precise and complete. Generally speaking, the scope of the work can best be described by reference to drawings and specifications that have been issued to the contractor for the work. Despite this fact, owners will often fail to properly identify the specific drawings and specifications that comprise the work to be performed. In some cases, drawings and specifications will be identified even when revised drawings are being prepared, or have already been issued.

Worse yet, the drawings and specifications incorporated by reference into the Construction Contract may sharply conflict with the requirements contained in the Contract itself.

The same problem arises with respect to contractor proposals incorporated by reference into the Contract. These proposals often contain "general conditions" type language that conflicts with the language contained in the Contract, or with the General Conditions used by the owner in connection with the Contract.

In addition, if there are particular areas of work that, for one reason or another, must be expressly included or excluded, they should be clearly spelled out in the Contract. Special issues that pose serious concerns, like asbestos removal, site work or utility work performed by others, easement or property restrictions, site access, staging of the work and interference with ongoing business operations, all affect the scope of the work and should be clearly identified in the Contract, or in an exhibit to the Contract.

If the Contract is based on a guaranteed maximum price, it is imperative that the owner sit down with the contractor and come up with a list of qualifications and exclusions to the guaranteed maximum price, so that both parties have a full and complete understanding of what is in the scope of work for the guaranteed price being placed in the Contract. It is not advisable, however, to attach exhibits to the Contract where the contractor has simply developed a list of what is included; it is precisely the opposite type of exhibit that is most helpful to the owner — a list of what is not included.

B. Completion Dates

One of the most important business terms in any Construction Contract is the date by which the construction must be completed. Owners generally make two primary mistakes when drafting this particular clause. In some cases, owners insert the completion date as an aspiration, where the contractor simply promises to use his best efforts to meet the date, without any legal obligation to do so.

In other cases, owners draft fairly complex completion date clauses that involve several milestone dates and include varying liquidated damage provisions.

In addition, owners often fail to spell out the consequences of not meeting milestone dates, particularly when the various milestones involve sequential work. The question of whether liquidated damages apply in cumulative fashion with each milestone that is missed, or whether only one amount applies, is often not defined, and, in some cases, this could lead to the entire liquidated damages clause being declared invalid and unenforceable.

DELAYS AND DELAY DAMAGES

One of the most important provisions in any construction contract is the provision dealing with delays in the completion of the work, and delay damages. Delays come about through a variety of causes, but frequently

arise as the result of design changes by the owner, errors in the plans and specifications, decisions by code officials or governmental entities, and simple inability on the part of the contractor to complete the work on schedule.

In most cases, construction contracts provide that the contractor will be entitled to an equitable extension of the contract completion dates in the event of delays to the work over which the contractor has no control.

Therefore, it is important for the owner to consider a delay clause that more specifically defines when time extensions will be granted. One common method of approaching this issue is to specify that the contractor will be entitled to an extension of time in the event of delay over which the contractor has no control, and which affects "the critical path activities of the work." This forces the contractor to prove that the alleged delay actually slowed completion of those critical items necessary to complete the work at a time when completion of the critical items was absolutely necessary. In other instances, owners have decided to include specific provisions on weather delays, how they are to be measured and what amount of weather delay is to be assumed by the contractor.

Contractors assert three primary types of damages in a delay situation: actual costs from subcontractors, job site overhead and home office overhead. In extreme cases, contractors may seek lost profits from unrelated work that could not be accepted because of the delay in the owner's project, and other purely consequential and even speculative damages.

If possible, owners should never agree to pay the home office overhead of the contractor, or its subcontractors. In the context of litigation, contractors frequently seek to calculate home office overhead on the basis of something called the "Eichleay formula," which is a calculation designed to allocate the home office overhead costs of a contractor to each separate construction project.

The construction owner should be just as careful in evaluating the types of damages the owner will be entitled to recover in the event of delay caused by the contractor. Unlike the contractor, the owner bears a significant risk of consequential damages on each construction project, particularly with respect to rental income or the generation of revenues from the-facility.

In some instances, liquidated damages may be appropriate. However, many owners fail to analyze the potential range of damages that could be suffered in the event of construction delay. In order to determine whether liquidated damages are appropriate, and the amount of those damages, every owner should carefully review the potential damages and costs that might arise as a result of construction delay.

When in doubt, the private construction owner should opt for actual damages, instead of liquidated damages, and maintain the ability to recover all of the damages that may arise from the construction delay. It is common

in recent years, particularly with the advent of the AIA A201 1997 General Conditions (as reaffirmed in the AIA A201 2007 General Conditions), for the owner to be faced with a request from the contractor for a waiver of consequential damages. This request is very problematic, for a number of reasons. While an owner might be sympathetic to the contractor's request to avoid unforeseen and remote damages stemming from a breach of the Contract, "consequential damages" cover a tremendous number of items that most owners would never relinquish, such as: (1) damages for delay; (2) damages arising out of defective work (moving a tenant to allow for corrective work); (3) damages covered by applicable insurance maintained by the contractor or its subcontractors; and (4) damages caused by intentional acts or omissions of the contractor or its subcontractors. Therefore, any owner who agrees to a waiver of consequential damages should be very careful to carve out exceptions for those damages the owner expects to recover in the event of a breach of the Contract.

INDEMNITY

The issue of indemnification is an important one in the context of construction projects. Standard industry forms, like the AIA A201 General Conditions form, contain a simple indemnity running from the contractor to the owner and the architect, and their consultants, agents and employees.

Some owners make the mistake of trying to indemnify themselves for claims caused by their sole negligence, when the law of many states does not permit such an indemnity. See, e.g., 0.C.G.A. § 13-8- 2(b) (Georgia's statutory prohibition on indemnities in construction contracts that indemnify the obligee against its own sole negligence). This rule is in effect in most states in one form or. another, such that the owner who builds projects across the country must understand the differences in the various statutes.

Owners may want to consider obtaining indemnity protection for claims caused "in whole or in part" by the contractor. In such situations, the owner's insurance is protected from claims allegedly caused by the joint negligence of the owner and contractor, and the contractor's insurance carrier would defend the entire claim. This has become more difficult to obtain from contractors in recent years, due to the fact that many larger contractors have very significant deductibles, and are unwilling to pay hundreds of thousands of dollars of their own money to cover claims caused by the joint negligence of the owner and the contractor.

In addition, owners may want to consider adding indemnity protection for claims and damages incurred as a result of the contractor's failure to perform in accordance with the construction contract.

This extended indemnity could also include attorney's fees incurred by the owner in defending claims that arise out of the contractor's failure to perform. One of the more unusual benefits of having an indemnity clause covering the contractor's failure to perform is that the presence of the express indemnity may cause the indemnified claims to be covered by, or

arguably covered by, various liability insurance policies carried by the contractor.

On the other side of the coin, contractors frequently seek indemnification from the owner for claims arising out of the discovery or removal of hazardous material, including asbestos and polychlorinated biphenyl (PCB). In these situations, it is important for the construction to owner to verify that it has insurance coverage for this type of indemnification and/or is willing to bear the risk. Many contractors ask for this indemnification because they cannot obtain the appropriate coverage, and construction owners need not make the same mistake.

NOTICE PROVISIONS

Construction contracts contain many types of notice provisions, and none are more important than those requiring a contractor to give notice of a potential claim to the owner.

The owner needs to ensure that all of the notice provisions carry the same primary message to the contractor -- give notice of your claim when the events causing the claim arise, or give up the claim. Typically, ten (10) to fourteen (14) days is adequate time for the contractor to understand that it has a potential claim, and to notify the owner of that claim in writing.

Notice provisions are extremely critical for two primary reasons. First, the owner needs to know how much the project is going to cost every step of the way in order to make intelligent budgetary decisions, including decisions as to whether to implement various design changes or additions to a given project. If the contractor is not informing the owner of potential claims, and is instead "saving" such claims for the end of the project, the owner has little or no control of project cost, and has no opportunity to reduce that additional cost, since it has no knowledge that a problem is occurring.

Second, it is far better for an owner to know of potential claims early, when they can be resolved in an amicable manner, and perhaps resolved at a substantial discount. Allowing claims to fester until the end of construction inevitably drives the amount of those claims higher, as contractors find more and more extra costs attributable to the claims, particularly if the project turns out to be unprofitable for the contractor.

Moreover, as a practical matter, every construction owner should ensure that its representatives do not waive, orally or in writing, the strict requirements of these notice clauses. It is not uncommon for a construction lawyer to find evidence of formal and informal waivers of notice provisions in all kinds of project documents

Conversely, the owner should be wary of agreeing to notice provisions requiring the owner to notify the contractor within a specific period of time of a claim for various matters under the Construction Contract. The owner is

generally not familiar with the day to day activities at the project site, and other facts that would be necessary in order to understand whether or not a potential claim existed.

TERMINATION

The termination clause of a construction contract is critical for three important reasons. First, the wording of a termination clause could affect the ability of an owner to proceed with the construction work if the contractor were to become insolvent or otherwise incapable of continuing the work. Second, termination clauses may or may not give the owner the flexibility of terminating the contract for convenience, and limit the damages payable to the contractor in those circumstances. Third, the wording of a termination clause may govern the damages paid to the owner in the event of a default by the contractor.

Any termination clause drafted by an owner should give the owner maximum flexibility in terminating the contractor quickly, if it appears that the contractor will simply not be able to complete the work.

Therefore, every termination clause should contain a provision allowing the owner to terminate, without advance notice, the contract for the convenience of the owner, even if the owner does not believe that it will ever become necessary to utilize that clause.

Of course, the termination for convenience provision, as well as the termination for cause provision, should have specific language addressing the damages to be paid in the event of a termination under either provision.

A termination for cause paragraph should specify that the owner will recover all damages resulting from the contractor's default, including any additional architectural fees and attorney's fees made necessary by the default. In addition, this paragraph should state that the owner will have no obligation to release any additional funds to the contractor until the work is completed and the costs to the owner of completing the work have been calculated.

Finally, any termination clause should contain a provision addressing the possibility of wrongful termination by the owner. This provision should specify that if the owner terminates the contract for cause, and it is later held that the owner did not have grounds to terminate the contract for cause, that the termination will be treated as a termination for convenience, and the damages payable to the contractor will be calculated under the termination for convenience provisions. This protects the owner in the event of a good faith termination of a contractor for cause when a jury or other finder of fact agrees with the contractor's position on whether the contractor should have been terminated.

PROGRESS PAYMENTS

Most progress payment provisions in construction contracts deal with the mechanics of how and when the contractor is to be paid, and rightly so. However, these provisions should also be drafted with a view toward using each progress payment as an opportunity to bring the project "current" in terms of outstanding matters or claims.

Owners should consider obtaining even more protection and comfort each time a progress payment is issued. For example, the lien waiver forms to be signed by the general contractor, subcontractors and suppliers should contain a general release of all claims, as well as liens, that any of those entities may have as of the date of the payment application.

In this way, the owner obtains some certainty that subcontractors and suppliers have not only been paid, but that those entities, as well as the general contractor, have no hidden or unasserted claims that could come back to haunt the owner at a later date.

There are other protections the owner should consider obtaining at the time of each progress payment. The owner may require, as a condition precedent to payment, submittal of an updated list of all subcontractors and suppliers on the project, so that the owner is aware of whether it is receiving all of the appropriate lien waivers. The owner may also require an updated project schedule with each payment application, so it can determine whether any significant delay issues are developing. Some owners even, require monthly progress reports outlining in detail the status of the various elements of the work, and identifying outstanding issues that are impacting the project cost or schedule.

STATUTES OF LIMITATION

Owners should never agree to clauses regulating the statute of limitations unless there are unusual circumstances that require such provisions. The owner should require the contractor to live with the statute of limitations rules applicable in the state where the project is located, as opposed to arbitrarily changing those rules for the pure benefit of the contractor.

CHANGES IN THE WORK

Changes in the work requiring an adjustment in the contract price or completion data should be allowed only by written change order, or other written authorization signed by both the contractor and the owner. Allowing one's construction representative to authorize verbal changes in the work without any supporting documentation is simply asking for trouble.

In addition, the owner should consider having their own version of a comprehensive change order form that specifically waives all claims, damages and extensions of time relating to a particular change unless they

are addressed or contained in the change order.

As to the issue of paying for changes in the work, once again the owner should make sure the contractor is required to notify the owner in writing of any claim for additional compensation, or time extensions, due to alleged changes in the work, or lose its right to assert the claim at a later date. An owner should make particular reference to the amount of profit and overhead (referred to as "markup") that will be allowed to both the contractor and its subcontractors in the event additional costs are incurred as a result of changes.

CONCLUSION

While virtually every clause of a construction contract is subject to some form of negotiation between the owner and the contractor, the negotiation process can become overly cumbersome if the owner and contractor end up negotiating every potential liability on a construction project, no matter how large or how small. Instead, an owner should focus on those provisions that address the biggest areas of liability for the owner, or those provisions that allow the owner some degree of control in limiting liability and exposure during the project. By doing so, the owner will be perceived as a fair and trustworthy participant in the project by the contractor, but will not be subject to unwanted and unnecessary liability.