



Owner/Contractor Agreements: A Drafter's Dozen by James Terry, Real Estate Weekly, August 24, 2011

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I recently stopped by Dunkin Donuts to fuel up before drafting an owner/contractor agreement for a new construction project. The customer ahead of me ordered a box of twelve donuts, which looked tantalizing despite the daunting calorie count prominently displayed, so I focused on the dozen rather than the donuts. After a Homer Simpsonsque reverie, I returned to work on the contract clauses – a dozen, in fact (doh!) – that should be carefully considered and clearly drafted to avoid potentially costly disputes during project performance.

Indemnification. The parties should agree on whether the contractor's indemnification will be limited to personal injury and property damage claims or will encompass economic damages incurred by the owner, such as mechanic's lien claims. The clause should also specify whether indemnity is limited to claims attributable to the negligence of the indemnifying contractor, or whether it will encompass all claims arising out of the contractor's scope of work, such that negligence of the contractor (or its subcontractors, for whom it is responsible) need not be established.

Key Personnel. The contract should identify key contractor personnel (like the project manager and superintendent) who cannot be replaced without the owner's consent. If those personnel are to devote their full time to the project, that commitment should be expressed.

Deadbands. Frequently, a monetary threshold of the amount of changes to the scope of work will be established, below which the contractor will not be entitled to additional fee. Changes up to that threshold are within a so-called deadband. The same principle may be applied to reductions in fee predicated upon deductive change orders.

Retainage. Subcontractor retainage of 10 percent on progress payments is common, and the parties may provide that such retainage will only be withheld until the subcontractor is 50 percent complete (assuming that no performance deficiencies exist at that juncture). If sums are to be withheld from the contractor itself, retainage of fee will likely be more palatable to the contractor than retainage on general conditions.

Contingency. The amount of construction contingency should be established, as well as its purposes (which may be specifically enumerated or left to the contractor's reasonable discretion). The degree of owner approval of contingency use should also be addressed.

Shared savings. If some contingency remains upon project completion, its allocation between owner and contractor should be determined. If the fruits of favorable trade buyouts are added to the contingency, the savings to be shared may be enhanced.

Delay provisions. Events giving rise to excusable delay should be enumerated. (For example, will unforeseen unavailability of labor or materials justify delay?) The extent of damages for delay, if any, must be considered; one solution is to allow the contractor to recover only demonstrable general conditions attributable to an excusable delay.

Liquidated Damages for Unexcused Delay. These will be the owner's sole remedy for contractor delay and must be reasonably computed so as to avoid characterization as an unenforceable penalty. Contracts often allow a grace period before liquidated damages commence to accrue, and they can also provide for incrementally higher damages the longer the unexcused delay in obtaining substantial completion continues.

Waiver of Consequential Damages. Consequential damages (such as increased financing costs) generally impact an owner more than a contractor, so owners think twice before waiving them. If not waived, they may be subject to some limitation of the contractor's liability (typically its fee or some multiple thereof).

Notices of Claim. Provisions governing the contractor's giving of notice of claims for time extension and/or additional compensation should be clear and reasonable as to timing and required content. Whether the standard is to be strict compliance or substantial compliance with those provisions should also be addressed. Further, will the delivery of late notice be an absolute bar to assertion of a claim or only a factor to be considered in assessing the claim?

Dispute Resolution. Owners typically favor litigation with its panoply of discovery devices, while contractors prefer the familiar and possibly speedier arbitration realm. A compromise is to have claims up to a threshold arbitrated, while larger claims are litigated. Also to be considered are specification of the forum (state/federal court venues in the locale of the project or particular ADR providers); whether nonbinding mediation must precede formal dispute resolution regardless of the forum; and waiver of a jury trial in litigated cases.

Termination for Convenience. Will the owner be entitled to exercise this right at any time for any reason or only in specified circumstances, such as sale of the property or loss of project financing? Will the contractor receive "lost opportunity" compensation beyond what it has earned for performing pre-termination work, given that it will likely require time to reallocate its project personnel to other endeavors? If all of this drafting induces hunger, then reach for a donut – just not all twelve.