

How Construction Contracts Cause Litigation

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We live in a litigious society, and construction contributes its fair share of disputes. Conflicts, disputes and claims seem to be an inevitable part of construction projects.

But conflicts on construction projects – and the resulting delays, disruptions and expense – can be minimized. History teaches that, while the parties and projects may change, the types of disputes generated by construction projects do not. Knowing the areas where conflict is likely to arise, and carefully planning to address them, can reduce the risk of conflicts and increase the chances of a successful project.

Some of the areas that generate conflicts are as follows:

One-Sided Contracts

Owner-drafted contracts frequently reflect the mentality that conflict can be avoided by protecting the owner from all possible claims. Such contracts contain exculpatory language, waivers and limitations intended to bar virtually all claims by the contractor. The idea is to protect the owner from all foreseeable and unforeseeable risks by shifting responsibility for those risks to someone else.

One-sided contracts, however, may generate as many claims as they prevent.

Construction claims principally are caused by: (a) unforeseen or changed project conditions; (b) changes in the work; (c) late provision of drawings, access, permits, equipment or materials; (d) inadequate drawings or specifications; and (e) interference in the work. When commencing construction, contractors justifiably expect that all necessary permits are in place, they will have access to the work, they will receive timely engineering and owner-supplied

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information, shop drawings will be promptly reviewed and unexpected conditions or changes will be fairly compensated. Where these expectations are not met, contractors often lose money on a project, prompting claims no matter what the contract provides. In a worst case scenario, severe losses may force a contractor out of business, resulting in a failure to complete the work and the attendant project delays, disruptions and increased costs.

Construction disputes are better avoided through a fair allocation of project risks. The guiding principles are that risks should be allocated (a) first, to the party who has direct control over the portion of the construction that creates the risk, (b) second, where no party has direct control, to the party who is best able to protect against an unexpected loss, and (c) where no party has any control, to the owner, who is the party that initiated the construction project and is the ultimate beneficiary of the results.

The Project Delivery System

The delivery system selected for a project, and the contract structure reflecting that system, can greatly affect the risk of conflicts regarding such fundamental issues as scope, time, money and risk allocation.

The traditional single-prime contract for a fixed price between the owner and contractor is the most commonly used and best understood project delivery format. This type of contract, with a clear chain of command, removes all ambiguity regarding which party is responsible for management of the construction work and which is responsible for the design.

Driven by market forces, recent decades have seen the use of innovative project delivery systems and contract forms reflecting those systems. Design-build, construction management and fast-track delivery systems often provide economic benefits to the owner. An owner may need an office building by April, a shopping center by June, or a school by September, necessitating

an alternative delivery approach to meet the owner's needs. Innovative project delivery systems, however, often blur the traditional roles and responsibilities of parties on a construction project. Use of non-traditional project delivery systems increases the risk of misunderstandings, particularly where the scope of work and compensation are changing continuously during the project. For these reasons, the contingencies involved in non-traditional construction approaches are greater than in the traditional single prime contract approach.

The Design

An incomplete, inaccurate or poorly coordinated design inevitably will produce a project with conflicts, unanticipated costs and delays. Conversely, nothing diminishes the risk of conflict, and provides more protection for the owner, more than an accurate and complete design.

To avoid project conflicts and disputes, owners should take measures to assure that the project plans are as complete and error-free as possible, such as by having the plans peer reviewed by independent designers and evaluated for constructability by a qualified contractor.

Site Conditions

Views differ on whether, and to what extent, a contract should provide additional compensation for differing site conditions. Some form contracts (such as the federal and American Institute of Architects standard general conditions) include a differing site conditions clause which entitles the contractor to additional compensation for unexpected subsurface conditions meeting certain criteria. Some owners (public and private) model their contracts on these forms. Other owners utilize contracts that are silent on the issue, or expressly prohibit recovery for differing site conditions while placing all of the risk of the unknown on the contractor.

The assurance of equitable compensation for differing site conditions encourages prudent contractors to submit lower bids that do not include contingencies for unknown conditions. Just as importantly, a differing site conditions clause helps protect prudent contractors against being underbid by competitors who are either too careless or too reckless to include such a contingency. Because hidden conditions can make the difference between a profitable contract and a financial disaster, contractors often insist on an equitable adjustment clause before submitting a bid on a job with significant risk of differing site conditions.

No matter which approach is taken, the wise owner will perform a thorough subsurface investigation so that as much as possible is known about the site. That information should be shared with the contractor. Reliable structural engineering and design, and realistic pricing by the contractor, cannot be generated in the absence of such knowledge. A thorough exploratory program by a competent engineering firm will diminish misunderstandings and disputes resulting from extra work and foundation failures when unforeseen site conditions are discovered.

Oversight of Construction

The prudent owner will keep a close eye on the progress of construction to head off problems or conflicts which may be brewing in the field. The owner generally has no contractual obligation to inspect or monitor construction; rather, the contractor has the obligation to provide its work in accordance with the plans and specifications, and free from defect. Nevertheless, the careful owner will monitor construction through on-site representatives who act as the owner's eyes and ears. That representative may be from the architect's office or it may be a permanent employee of an owner who is experienced in construction.

Unfortunately, some owners, even on large projects, attempt to avoid overhead costs by cutting corners here. Even if an owner ultimately proves that the contractor made a bad pour or

connected the steel improperly, it is infinitely better that the defect be discovered early rather than well into the construction stage, where litigation is usually the result. By regularly reviewing construction activities using a variety of methods, an owner improves the chances of uncovering conflicts, reducing unexpected change orders, detecting potential design errors, revealing poor construction practices and avoiding project delays.

Contractor Submittals

The shop drawing process seeks to avoid failures and misunderstandings by allowing the contractor to demonstrate the detailed application of the architect's or engineer's design. The process of shop drawing submittal and review is intended to be a dialogue between the designer and builders concerning the details of construction. It is here that the owner, contractor and designers have the best opportunity to avoid non-conforming or defective work.

To avoid problems, the owner should make sure that the contractor and designers each carry out their unique responsibilities for shop drawing review. The purpose shop drawing review by the contractor is to coordinate the trades and verify that the project can be built. The designers review the shop drawings to ensure that the proposed construction scheme meets the design intent for the completed structure. Failure by either to properly perform these duties increases the risk of project conflicts, defects and problems.

Conclusion

The areas discussed above, if given proper attention, present opportunities to reduce conflict on construction projects. Knowing where conflicts are likely to arise, and carefully planning to address those areas, can reduce the risk of conflict and therefore increase the chance of a successful project for all concerned.