

Five Critical Clauses Contractors Should Know

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Contractors wade in a sea of risk for every project, and well-crafted contracts can protect all involved parties. In this installment on the allocation of risk between general contractors and developers in construction contracts, we'll explore five critical general contract clauses contractors should know.

1. LIQUIDATED DAMAGES

Liquidated damages clauses typically establish a sum certain per day to determine damages the developer will suffer if the contract is not completed on time. Many contractors (and their sureties) treat liquidated damages provisions as anathema. However, such clauses can be beneficial to a contractor for several reasons. First, these clauses help quantify the risk of contractor-caused or inexcusable delays, which may assist the contractor in pricing the project and analyzing the risk should a delay occur. If the contract contains an enforceable liquidated damages provision, the developer usually will only be able to recover the liquidated damage amount, regardless of whether actual delay damages exceed the stipulated sum. Properly drafted clauses also help prevent much of the time, expense, and uncertainty in resolving disputes arising from construction delays. Also, a contractor may be able to negotiate a cap on liquidated damages.

It is critical for contractors to understand that to hold a contractor liable for liquidated damages, the developer must still prove that the contractor caused or was otherwise



responsible for the delay. That element of a claim is not negated just because the measure of damages per day is uncontested.

Occasionally, a liquidated damages clause may be structured to allow certain damages to be liquidated and other predictable and ascertainable delay-caused losses to be recovered based on actual expenses. The contractor should recognize and resist these types of clauses, as they negate part of the benefit the contractor may obtain from the provisions.

2. CHANGES

A changes clause modifies the common law of contracts by allowing one party – the developer – to unilaterally change the contractor's required performance without breaching the

contract. The clause gives a developer the necessary flexibility to adapt to the actual conditions of construction to achieve the project's underlying purpose. For example, developers can correct errors and omissions in the plans and specifications and meet unanticipated needs and conditions. In exchange, the contractor has the right to an equitable adjustment to the contract schedule or to additional compensation, or both, to complete the changed work.

When evaluating a changes clause proposed by a developer, the contractor should look for the following:

- » The requirement that the developer provide written authorization and direction to proceed with changed work, as well as an accurate and complete description of the changes.
- » A clear and detailed basis for determining the value of the changed work, addressing both additive and deductive changes.
- » A requirement that the contractor give the developer notice of the changed work, and the contents of the notice.
- » Clear direction regarding contractor markups and other pricing for the changes.
- » A pricing mechanism that anticipates variations in quantities and predetermines the resulting effects on cost.

In addition to understanding and evaluating these specific terms, a contractor should also carefully review and negotiate the terms and conditions of the documented change order itself, if necessary. It is especially important to look at the scope of any release or waiver language in the change order form. The contractor should resist any clause that attempts to waive any claims it may have beyond the impacts of the specific change addressed in the change order. For example, a change order form custom-drafted by a developer may require the contractor to waive not only the effects of the specific change dealt with by the change order, but all other impacts of the current change order when taken in the context of all the other change orders, past or future, resulting from other changes in the work. Execution of such a change order would substantially increase the contractor's risk of waiving any claim to such cumulative impacts, which could be substantial over the course of the project.

Of course, the contractor should also be certain it understands and complies with notice and documentation requirements of

the clause, and that its employees who may deal with changes are aware of and compliant with them. Failure to comply could be grounds for finding that the contractor waived an otherwise valid claim.

3. TERMINATION

Construction contracts typically include two types of clauses that allow the developer to cancel the contract: termination for default and termination for convenience. These clauses address different contexts and risks for both parties.

1. Termination for Default (T4D)

This clause provides a drastic remedy. T4D almost always results in complete polarization of the parties and has long-lasting effects for the contractor, which will have this action on its record. The contractor should ensure that any clause dealing with a T4D requires that the default be material, adequate notice is given, a reasonable right to cure the default is provided, and reasonable time limits are allowed.

The contractor also should require that the materiality of a breach be defined as specifically as possible. Additionally, the clause should specifically require that the notice to identify how the contractor allegedly breached the contract refer to specific contract provisions, include a description of the contractor's acts constituting the breach, and specifically identify how the contractor may cure the alleged default and the time within which it must be cured.

2. Termination for Convenience (T4C)

Most contracts include clauses allowing the developer to terminate for its own convenience without any default on the part of the contractor. Important components of such provisions, and the frequent cause of extended negotiations or disputes, include provisions dealing with what happens after a developer invokes a T4C. The contractor should ensure that the clause specifically identifies what actions both parties must take, particularly whether the developer is required to pay the contractor some or all of the profit the contractor would have earned had the project not been terminated. The contractor should look for the ability to collect at least a portion of such profit. Alternatively, both parties could agree on a predetermined amount or a method for determining the amount of such recovery by the contractor.

Additionally, the contractor should look for a conversion clause that would require a T4D to be converted to a T4C if T4D was later determined to be wrongful. This clause will prevent the contractor from claiming that the wrongful T4D was a breach of the contract, which could open up the possibility of standard damages for breach of contract. Instead, the contractor would be limited to the compensation in the contract for a T4C. A conversion clause could automatically prevent the contractor from proving and collecting considerable damages for the developer's breach and should be avoided by the contractor.

4. NO DAMAGES FOR DELAY


A no-damages-for-delay clause is an attempt by developers to limit exposure to contractors resulting from project delay caused by the developer or an entity for which the developer is legally responsible. Under such clauses, the contractor's recovery for a developer-caused delay is limited to an extension in the completion date. The general intent of the clause is to shift the monetary risk of delay from the developer to the contractor, usually regardless of the cause.

These clauses generally are enforceable, although courts have found numerous ways to either restrict or circumvent the provisions. A contractor should strongly resist such clauses because of the obvious risk they impart to the contractor. Even if a clause is ultimately found to be unenforceable, the battle to defeat it could be lengthy and expensive, and the ultimate result would be uncertain. It is best to avoid this.

5. NOTICE

Construction contracts typically require the contractor to give the developer written notice of circumstances that may lead to a claim for additional money or time. The clause is frequently very specific about the timing and content of the notice. Failure to give notice as required can result in denial of the contractor's claim.

Jurisdictions vary on strict notice compliance. Disputes often involve claims of constructive or actual notice and of prejudice to the developer. The contractor should review a proposed notice clause carefully, looking for red-flag language stipulating that strict compliance is necessary; that failure to comply strictly will be deemed a waiver of the contractor's claim; and that the concepts of actual or constructive notice,

lack of prejudice and other similar conditions will not excuse the contractor's failure to comply. Such specific provisions increase the contractor's risk if it fails to comply with the clause. A general contractor will have difficulty negotiating changes to these provisions. Absent such changes, the safest alternative is to mitigate the risk by assuring that all employees with any responsibility for claims are aware of the notice requirements and that they comply punctiliously with them. 



About the Author

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