



# NAC Executive Insights

## Claims Avoidance from An Owner's Perspective

### Key Points

- Major contributors to claims include lack of alignment (owner-contractor; owner's team; contractor's team); failure of owners to meet their obligations; unforeseen site conditions; inadequate change control; and poor contractor performance.
- The shortlisting process, when properly applied, provides the client with an effective means of reducing exposure to or avoiding claims. It also assures capable, competent, and resourced contractors to perform the work.
- Recordkeeping is critical. Early resolution of potential claims and avoidance of formal disputes rest heavily on the quality of records prepared contemporaneously during the project.
- Management of change processes must be communicated clearly to project teams.<sup>1</sup>
- Ensure financial approval levels for changes are appropriate for work at hand.
- Specify how costs are calculated for changes<sup>i</sup> (for example, the schedule of rates) to aid in elimination of claims in favor of readily negotiated changes.
- Resolve issues quickly and fairly.

### Introduction

This Executive Insight will look at claims avoidance from an owner's perspective. This Insight, however, also serves as a guide for contractors to ensure completeness of bids, smooth execution of work, reasonableness of any claims brought forward, and the likelihood of success regarding those claims. Contractors may be subject to claims from clients as well. This Insight provides guidance to protect the contractor. This Executive Insight will look across the contracting cycle, defined here as including the following:

- Pre-tender
- Tender
- Contract
- Project execution
- Close out

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<sup>1</sup> On one large project, a joint session was held by client and contractor and their joint management teams. Scope was jointly reviewed and the change order process laid out.

Avoidance measures common to all phases include:

- Owner behaviors — one voice; timely
- Knowledge of the contract
- Recordkeeping

### **What Is a Claim?**

A construction claim is a legitimate request for compensation or extension of time outside the provisions of the contract. It does not include changes requested in writing, negotiated, agreed to, or reflected in modifications to the contract.

### **Why Is Claims Avoidance Important?**

Claims avoidance is important to project owners, not only because of the financial implications of claims, but also because of:

- Their likely impacts on project schedule.
- Increased likelihood of transitioning into formal disputes<sup>ii</sup> with attendant increases in management time and legal costs.
- Potentially corrosive effects on partnering relationships, often resulting in elevation of routine issues into formal claims or disputes.
- Impacts on contractor's financial position and capacities if not resolved in a timely manner. Uncertainty of resolution can be as bad as an unfavorable claim outcome in many instances.

The number of claims has been growing, driven by both increasing competitiveness in bids (win and claim) and weaknesses in many owner organization's capabilities.

### **What Drives Construction Claims?**

Construction claims in large part are driven by what happens or fails to happen before the contract is even executed. Among the drivers of claims in the pre-contract stage are:

- Poor owner readiness, including:<sup>iii</sup>
  - lack of clarity on the strategic business outcomes<sup>iv</sup> (SBOs) to be achieved through execution of the contract.
  - inadequate alignment within the owner's organization on these SBOs, resulting in contract ambiguity or conflicting owner's project requirements (OPR).
  - weak decision-making processes and inadequate clarity of roles and responsibilities.
- Inadequate engagement by the owner with the contracting community and bidders, resulting in incomplete information, lack of clarity, and a less than transparent disclosure and discussion on the nature of the work to be performed and its risks.
- Unrealistic owner's expectations related to project schedule.
- Excessive constraints on means and methods available to the contractor.

- Incomplete project scope<sup>v</sup> and OPR; wants exceed needs and lack clarity and contractual intent.
- Poorly written contracts:
  - incomplete contract
  - improper precedence of documents
  - contract scope inconsistent with information provided to or available to bidders
- Inadequate shortlisting process, which allows bidders less than qualified for the project at hand and in the designated timeframe to participate.
- General bidding climate drives overly aggressive bids, increasing the pressure on contractors to claim.
- Shortlisted contractors subject to profit pressures from other project portfolio performance issues.
- Inadequate tender phase due diligence.
- Incomplete responses to contractor questions during tender process, resulting in increased risk to contractor.
- Inadequate documentation and recordkeeping during the pre-contract phase.

Also contributing to construction claims are:

- Lack of timely contract execution and notice to proceed:
  - May lead to delay claims before project ever commences.
  - Indicative of future delays in executing agreed-to changes.
- Execution of an incomplete contract.
- Inadequate attention in contract development to typical sources of claims as outlined in the next section.

### **What Are the Sources of Construction Claims?**

No listing of potential sources of construction claims will ever be complete, but some recurring reasons include:

- Incomplete or inadequate bid information
- Incomplete or poor quality drawings and/or specifications
  - incomplete basis of design (BOD)
  - conflicting requirements
  - high level of Requests for Information (RFIs)
  - work different than called for in drawings and specifications
- Changes to scope, including increases, decreases, and modifications
- Changes in means and methods of construction
- Intermittent operations required because of inadequate owner drawings or specifications; owner directed changes; limitations imposed by regulators; unforeseen or undisclosed circumstances; lack of coordination with other contractors or owners operations; lack of design information that is timely and complete; or supply chain performance
- Work in congested areas

- Defective or late owner-furnished equipment and materials<sup>vi</sup>
- Project acceleration to regain schedule

## Pre-Tender Phase

Emphasis in this Executive Insight on the importance of the pre-tender phase has been highlighted, including the importance of:

- Clarity and communication of strategic business objectives (SBOs)
- Completeness of scope and owner’s project requirements (OPRs)
- Reasonableness of requirements and constraints

The pre-tender phase is where the greatest opportunity for claims avoidance exists. Consider this the claims inoculation stage.

Specific activities at this stage to aid in the avoidance of claims include:

- Development of a written statement of SBOs to be accomplished/supported by undertaking of the project and the particular contract
- Agreement/approval of the developed SBO statement and communication to the owner’s team, including contracting and legal staff. On multi-contract projects, the holistic consideration of all projects/contracts from a program management<sup>vii</sup> perspective is essential to minimize the potential for conflicts, overlaps, or “white spaces”<sup>viii</sup> gaps, with attendant risks
- Development of an integrated project plan that reflects owner and contractor activities and interfaces
- Development of an overall risk register<sup>ix</sup> that identifies the party best able to manage the risk and the logical risk sharing and management approaches. It is essential at this stage to document assumptions<sup>x</sup> made and areas and levels of uncertainty. Assumption migration should be tracked throughout the project by the party retaining the risk.
- Conduct formal owner readiness review.
- Develop OPRs and complete scope; review to confirm fit-for-purpose.
- Ensure expanded basis of design<sup>xi</sup> (BOD<sup>x</sup>) requirements are fully reflected in the owner’s project requirements and scope.
- Assemble all information available and required by bidders during the tender phase. Identify any gaps in required information and approach to obtaining or enabling bidder to obtain and any associated impacts on risk posture (retain or transfer with likely premium). Identify information to be incorporated into the contract directly or by reference.
- Establish realistic timeframe for the project and test schedule utilizing reference class forecasting.
- Define project management requirements the selected contractor must meet, including level of reporting (prime<sup>xii</sup> only or which level of subcontractors), content, and frequency. Establish any conditions requiring immediate notification.
- Develop any formal risk sharing or incentive schemes and test for consistency with other items developed at the pre-tender stage.

- Establish bidder pre-qualification criteria to focus the bidders list on the most qualified firms. Emphasis should be on differentiated skills, capabilities, and capacities.
- Establish method of quality and progress measurements and reporting.
- Established requirement for turnover documentation, including BIM models to be used in facility management.

**The pre-tender phase is the single best opportunity to avoid claims. Unfortunately and all too often, these efforts receive inadequate attention. The lesson of “going slow in order to go fast” is often lost.**

## Tender Phase

Claims avoidance measures continue into the tender phase, building on the good work undertaken during the pre-tender phase. Deferral of pre-tender activities to the tender phase is not recommended. When this does occur, completeness of documents may be found lacking and internal consistency may be absent.

High-quality tenders are the first step in the tender phase. Clients may choose a two (or more) step process, where the first step is focused on prequalification of bidders to develop a highly qualified shortlist. Screening at this stage is essential to ensure high-quality, technically competent, and competitively priced bids. Note the focus on competitively priced as contrasted with the irrationally lowball bids seen in the industry, which result in a bid and claim execution strategy.

Owners may choose to undertake best value procurements, where nonfinancial factors are weighed together with price. Avoidance of bid protest requires absolute clarity around nonfinancial factors.

Claims avoidance strategies at the tender phase include:

- More rather than less information available to bidders.
- Ready identification of known information gaps or areas where the owner has assessed that a high degree of uncertainty exists.
- Mandatory site visits or facility walk-throughs.
- Complete and timely response to bidders’ queries. Last-minute responses are of limited value and may act to increase contractor pricing.
- Formal presentation/review of project scope with bidders together with written response to questions.
- Formal review of owner-identified risks that may affect the project and contract. This documented process assures clarity of risk and responsibilities and has proven to be beneficial, especially in shared risk and contingency contracting structures. These reviews also support subsequent partnering efforts and provide another layer of claims inoculation.
- Clarity on any claims process, including notice provisions, time limits, response and resolution, and subsequent dispute processes.

- Clear, fair (not arbitrary or onerous), and timely payment provisions, with contractor rights and entitlements for withheld payments clearly spelled out.
- Review of other requirements addressed in the pre-tender stage (reporting, documentation).
- Development of a record of negotiation (including clarity on how the official project schedule is handled and maintained and who owns project float) signed by clients and contractor in conjunction with contract execution.

Like the pre-tender phase, the tender phase goes a long way towards setting up the project to avoid claims.

## Contract

The end of the tender phase, including bid evaluation and negotiation, results in execution of a contract for the works to be performed. It is important at this stage that there be no ambiguity in the work to be performed. In particular, attention must be paid to any external approvals or filings associated with the execution of the contract or any financial documentation or bonds required from the contractor. Timeframes for provisions are typically included in contract requirements. Failing to meet these early commitments may be a harbinger of future problems, including claims.

One item of the executed contract that often establishes a basis for an initial claim is a delay in issuing a notice to proceed (NTP). After contract negotiations, the NTP date should be either directly stated in the contract (for example, April 22, 2022) or stated in terms of not more than so many days after contract execution (which itself should be a defined term). Delays in NTP issuance have resulted in significant contract claims.

Contracts always should require “force account rates” from bidders to cover any situation in which a lump sum or unit rate is not agreed upon.

**Owner and contractor should both fairly interpret the contract, considering the totality of the agreement. Owners should note any ambiguity that is present in the contract is always against the drafter of the contract.**

## Project Execution Phase

During project execution,<sup>xiii</sup> construction claims may arise from a myriad of sources. These have been outlined earlier together with what drives many of these claims. These are not repeated here.

During the project execution stage, claim avoidance is supported by diligent owner engagement and oversight processes and documentation required by the contract. Examples of these requirements include:

- Transparent and frequent reporting of quality inspection, productivity<sup>xiv xv</sup> and work process, including measured quantities.
- Tracking and timely response to RFIs.
- Timely processing of agreed-to changes, leading to incorporation in contract documents.
- Timely contractor description of extra work or extra time, whether compensable or not. A struggling contractor is a leading indicator of future claims.
- Milestone and commitment tracking, with any delays by either owner or contractor noted. Any disagreement in such assessments should be reconciled contemporaneously.
- Adequacy and completeness of required and/or agreed to recordkeeping. Table 1 shows typical records to be completed and issued in a timely manner.

<b>Table 1: Typical Records to be Completed and Issued in a Timely Manner</b>	
<b>Daily reports</b>	Daily progress records
	Daily time records
	Daily workforce reports
	Daily production logs
	Daily equipment reports
<b>Progress reports</b>	Cost/labor reports
	Exception reports
	Job schedules
<b>Safety reports</b>	Near miss and accident reports
<b>Quality records and reports</b>	Inspection reports
	Photographs, videos (time stamped) (i.e., soils)
	Shop inspection reports
	Vendor quality surveys
<b>Design</b>	Drawing logs
	Drawings and specifications
	Shop drawings
	Transmittals
	RFIs and responses
<b>Supply chain</b>	Purchase orders
	Expediting reports
	Delivery reports of permanent materials
<b>Reports and communication</b>	Project correspondence
	Diaries
	Minutes of jobsite meetings or other meetings
	Memos to file
<b>Contract and payments</b>	Change orders
	Progress payments
	Notices

The owner is advised to alert the contractor formally of an inability on the owner’s part to meet their obligations under the contract. This should be promptly confirmed in writing with all available details, including identification of yet unknown material facts. Issues and problems will arise for both parties in

performance of the contract. Quick, transparent communication and timely resolution are essential. Failing to do so will result in claims that will only grow in severity. Remember “delay and denial” are not effective strategies.

The owner’s project team will benefit from an approved contract summary and clear guidance on responsibilities, levels of approval, and any approval or contract modification process. Any direction to the contract should only be provided in writing and the basis for direction documented and any basis for a contract change noted and communicated to the contractor to establish a shared record. Any required approvals on means and methods should not be unreasonably withheld or approval delayed. Directing the contractor to utilize alternate means and methods often undoes the inoculation put in place pre-contract.

**It is helpful to create project-specific flow diagrams that show how the decision making process, submittal process, and change order process are being handled by every member of the construction team.**

When a claim arises, relevant records should be assembled for review and any equitable adjustment. Letters and memorandum to file written long after the change event are less valuable and convincing than contemporaneous documentation and communication. Owner-generated communication throughout the project must be drafted such as not to create an unintended change to the contract requirements or provide support to the contractor in any subsequent claim. Documents at one stage may take on increased importance later in the project.

## **Project Closeout**

Project closeout is focused on confirming satisfactory completion of all works in accordance with the contract. Closeout processes should result in a contractor certifying the works (in whole or in part) are complete and the owner has accepted such works. Post-contract guarantees or warranties should commence in accordance with contract requirements.

Final turnover<sup>xvi</sup> and acceptance of the work may be conditioned on resolution of outstanding claims and any already approved amounts for the completed work. Care must be taken to ensure any acceptance or lack of acceptance of certified works does not create unintended consequences, including creating a new basis for a claim.

Certification of payments by the owner should be a simple process, providing for prompt payment and eliminating a commonly disputed area.

Claims avoidance at this stage includes:



- Inspecting and preparing a detailed punch list for the completion of each project area to ensure works are complete in accordance with the contract. Contractor shall confirm the punch lists are consistent with contract requirements and does not create a new basis for claim.
- Obtain all material and equipment warranty information and confirm the warranties meet contract requirements.
- Observe performance testing of all equipment and systems, noting any deficiencies for further correction or as a basis for a claim against the contractor or any adjustment for any guarantee or warranty provision.
- Assure completeness of written operating and maintenance documentation and procedures and completion of any required contractor- or vendor-provided training.
- Review, confirm, and accept as-built drawings showing all deviations and changes from the contract drawings and specifications and confirm they are reflected in any BIM deliverable.
- Obtain written guarantees, warranties, and bonds required by the contract.
- Resolve any outstanding claims.
- Make any required adjustments to the contract sums, including any back charges, and account for delay penalties and incentives earned.
- Obtain full release of claims from the contractor.

## **Post-Close-Out**

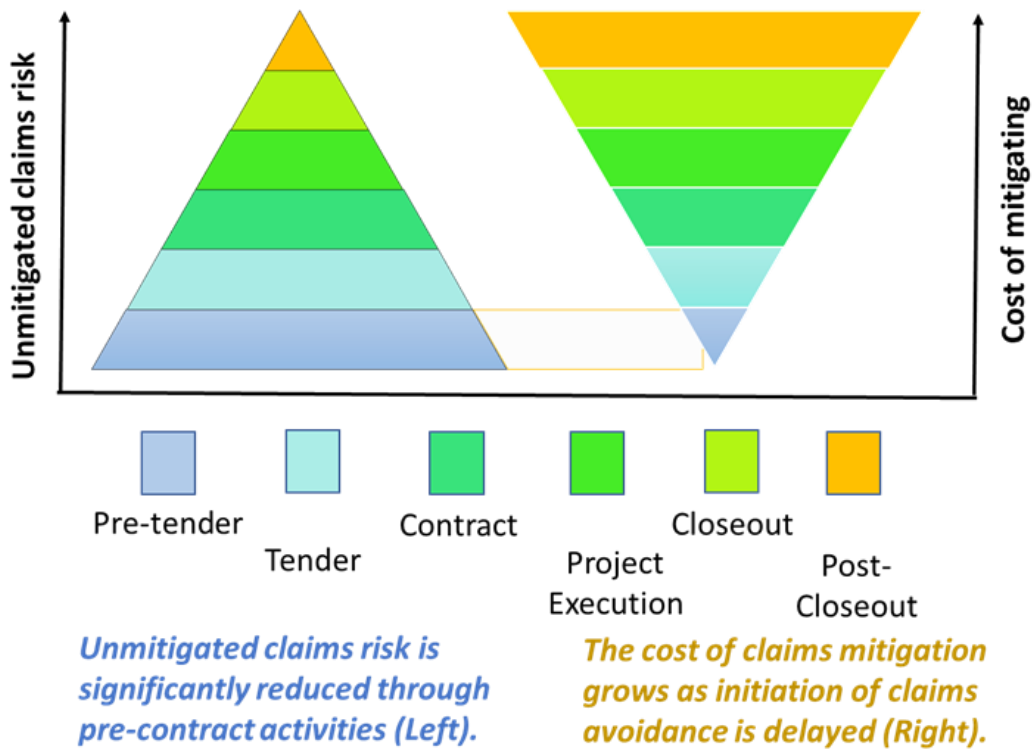
Claims post-close-out of the construction contract should be limited to guarantees and warranties provided by the construction contractor, but also may arise from the owner's failure to meet the operating and maintenance requirements associated with the provided guarantees and warranties. As such, claims in this stage may be bi-directional (contractor to owner and owner to contractor).

Guarantees and warranties are not addressed in this Executive Insight.

## **Summary**

Claims avoidance begins at the pre-tender stage. By the time the contract is executed, much of the potential inoculation of the project from claims has already taken place. A review of tender documents to ensure ambiguities and discrepancies are not present addresses a major source of claims. Contract documents with ambiguities, discrepancies, and conflicts make resolution of potential claims difficult, often driving items into the formal claims process and even into the dispute process. Management of all project documents and records through comprehensive document control is an integral part of claims avoidance.

Owners are encouraged to make the necessary investments at the pre-tender stage. Sometimes it is better "to go slow in order to go fast."



## About the Author

Bob Prieto was elected to the National Academy of Construction in 2011. He is a senior executive who is effective in shaping and executing business strategy and a recognized leader within the infrastructure, engineering, and construction industries.

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The following NAC Executive Insights were cited in this article:

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- i Estimating Construction Change Orders
  - ii Common Causes of Disputes and Claims in Large Complex Projects
  - iii Owner Readiness
  - iv The Importance of Strategic Business Objectives
  - v Know What You Are Trying to Accomplish: The Primacy of the Scope Baseline
  - vi Materials Management
  - vii Governance Under Program Management
  - viii White Space Risks
  - ix Owner's Risk Checklist
  - x Executive Insight Assumption, Risk Driver and Constraint Tracking
  - xi Business Basis of Design
  - xii Prime Contract Management
  - xiii Construction Execution
  - xiv Barriers to Productivity
  - xv Factors Affecting Productivity
  - xvi Construction Turnover