

## Mastering Construction Contracts

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Would you believe that a piece of paper is strong enough to stop the damage from a burst pipe or a collapsed wall? Construction contracts can all look the same, with pages and pages of impossible-to-understand legalese, and they can be tedious to read. But within those paragraphs, even the smallest of word choices can have an alarming impact on the future of a contracting business.

When something goes wrong on a construction project where there are several different businesses working together, a legal dance of pass-the-blame usually follows. For instance, suppose that weeks after an office building is restructured, the pipes burst, causing water to flood the offices. The property owner might then sue the plumbing company for damages. Because the general contractor hired the plumbing company, the contractor could also be held responsible for negligent hiring, facing serious financial, legal, and reputational consequences if sued. For even the most flawless of contractors, the best defense is a strong contract. Often, construction contracts are not given the attention they deserve and are signed without being read fully.

To develop an ironclad contract, it's important to recognize that a contract sets the stage for the 3 C's: commitment, communication, and collaboration between two parties. A well-negotiated contract highlights the contractor's value, establishes clear boundaries, and fosters a stronger engagement in the long run.

Construction professionals should view crafting a contract like



building a suit of armor for their beloved business, personal reputation, and finances, but what should be included?

### KEY COMPONENTS OF A SUCCESSFUL CONSTRUCTION CONTRACT

To establish a mutually beneficial partnership between a professional and a client, follow the five key components to include in a construction contract.

#### 1. CLEAR SCOPE OF WORK

It is important not to rush into a project without a well-defined scope of work (SOW) as it could open the door for client misunderstandings, scope creep, overages, potential allegations of falling short on work, and more.

Just as a contractor must lay down a solid foundation before starting a project, they also must develop a well-defined SOW to ensure a successful engagement. By outlining project objectives, labor materials, schedules, budgets, payment terms, and more, the SOW defines the exact roles and responsibilities of the hired professionals.

When designing an SOW, it is crucial to make transparency the top priority. This aligns both parties and reduces the likelihood of a breach of contract.

## 2. INDEMNIFICATION PROVISION

Another essential element of a construction contract is an indemnification provision. This clause mitigates risk by shifting the liability from one party to another. In layman's terms, one party will be responsible if a project goes south. An indemnification provision says that the indemnitor, the party who agrees to take responsibility for the damages, will reimburse the indemnitee, the protected individual, for actual losses.

For instance, a construction contractor hires an electrical group to install light fixtures and outlets in a new office building. The electricians install faulty wrap lights that spark, and nearby office equipment catches fire. The office owner sues the contractor for the damages. Because the general contractor included an indemnification provision in their agreement with the electrical group, the electricians would compensate the contractor for the costs.

## 3. HOLD HARMLESS PROVISIONS

Often confused with an indemnification provision, a hold harmless provision is another important way to manage risk. Generally, indemnification provisions contain language stating that the indemnitor will "hold" the other party "harmless." To hold harmless is a promise to pay any costs that may result from a claim covered by the indemnity provision, including any subsequent fallout stemming from the covered claim and/or its settlement.

For example, a general contractor enlists a trade partnering group to build a ceiling in a warehouse. There are inconsistencies in the trade partner's installation of steel beams, and when the ceiling is finished, a portion of it falls onto a warehouse worker, causing harm. The worker files a

lawsuit against the general contractor; however, if a hold harmless provision is included in the contract, the trade partners responsible for building the warehouse ceiling will take full responsibility and reimburse the general contractor for the financial and legal damages of their own errors and negligence.

It is important to note that the exact interpretation of what "hold harmless" means differs from state to state. Most states provide that "hold harmless" and "indemnify" mean the same thing, while a minority view them as separate. Therefore, it is important to understand your state's laws and speak with an attorney to make sure you are adequately protected by your indemnification provision.

In states that hold the minority position, contractors should ensure that hold harmless language is included in the indemnification provision. This will protect the general contractor from financial losses, allowing them to be made whole for expenses, losses, damages, and other financial risks, as well as liabilities such as bodily injury, design defects, accidents, or negligence. So not only will a trade partner have to make the general contractor whole for financial losses, they also will not be able to pursue litigation for any injuries caused by accidents or negligence.

## 4. LIMITATION OF LIABILITY CLAUSE

A limitation of liability clause is a crucial protection in a contract, capping the financial amount a party will pay for errors related to their work. This clause is essential for preventing significant financial losses from third-party claims. Imagine a contractor is paid \$30,000 to demolish a few floors of a commercial building, but a mistake made by the contractor affects the entire property. Without this clause, the contractor could be held liable for the entire value of the property, leading to disproportionate financial consequences.

The limitation of liability should reflect the portion of the project the contractor is involved in or a pre-agreed amount negotiated with the client. Some insurers advise against entering construction contracts without a limitation of liability clause, as a contractor could be sued and held liable for amounts far exceeding the value of their specific work. Including this clause ensures that financial responsibility is fair and proportionate.

## 5. CHANGE ORDERS

Finally, not every project will go as planned. In anticipation of scope creep, which is often typical as projects evolve, contractors should incorporate a section on “modifications.” Approved by both parties when the contract is first developed, a “changes to work” section confirms that a contractor’s scope may be susceptible to change, affecting their work or compensation.

If a hotel owner submits a change order to expand in the hotel’s ground-level restaurant, this clause requires the general contractor to perform the request. Before tackling the job, the contractor and owner will agree to a modified scope with an adjusted project, timeline, budget, etc., to satisfy the request.


Thirty percent of all projects involve a change order, so it is essential to include a “changes to work” clause to promote flexibility and adaptability and avoid client disputes.

### WHAT SHOULD BE INCLUDED IN A TRADE PARTNER’S AGREEMENT?

If a general contractor outsources to specialist groups, such as plumbers or electricians, they should ensure that those agreements contain the same provisions listed above. This way, liability is properly managed, and neither party will be unfairly held responsible when the unexpected happens.

### IMPORTANCE OF INSURANCE COVERAGE

There are inherent dangers in the construction industry, so it is imperative that contractors and trade partners are adequately insured. At a minimum, groups should carry general liability and professional liability insurance to protect against injuries, property damage, or claims of error, negligence, or design flaws. These policies help ensure the teams can rebound financially, operationally, and reputationally if such claims arise.

All in all, a construction contractor should always draft terms that are most favorable to them as the beginning point for negotiations. Up-front negotiations and contract clarifications are advantageous and the first step to kicking off a successful partnership. Make sure that if you have any legal questions regarding contract negotiations, you consult with an attorney. For all involved parties, properly structured construction contracts are critical to manage risks, protect against liabilities, and ensure smooth project execution. 



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### About the Author

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Tyler Peterson is the head of professional risks at [Hiscox USA](#), responsible for overseeing the professional liability offering for the small business insurer. With over a decade of experience at Hiscox, she has developed insurance products for customers around the world, and currently serves customers across the professional services, health care, technology, media, and construction sectors.

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### About the Article

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