



Risk Control Guidelines |
Risk Control Guidelines
Contractor's Series

Developing a
Construction Contract:
Clauses to Consider

A contract is as important to the success of any project as the estimate. Unfortunately, contractors only spend a fraction of the time reviewing a contract as they do in preparing their bid. As a consequence, tight profit margins are quickly exceeded by claims that are not properly controlled by the contract.

A key to minimizing and controlling risk is the contract. A contract, while it will not guarantee that a claim will be avoided, can greatly control and reduce a contractor's liability exposure. Following are a few contract clauses that may warrant special consideration.

Changed Site Conditions

ANALYSIS AND COMMENTS

A "Changed Conditions" claim is not an automatic right. The contract must expressly provide for the ability to make a claim if the situation arises. Often the contract will set a review standard and time frame in which to make a claim. These contract clauses will indicate the condition(s) that must exist to warrant recovery. Any procedures set for submitting a claim must be followed. Failure to follow procedures could result in a waiver of the claim. A Changed Conditions clause will typically permit recovery for "unforeseen" conditions, as a contract right. Disclaimers and exculpatory clauses may limit the Owner's liability for unforeseen conditions. Burden of proof and risk of loss are often shifted to the Contractor by requiring it to inspect the site and prove that the condition would not have been discovered by a reasonable inspection. Disclaimers may be negated if the Owner is discovered to have withheld significant information from the Contractor regarding the project site conditions.

CONTRACT CLAUSES TO CONSIDER

- "Contract sum will be equitably adjusted for conditions which are (1) at variance or differ materially from those indicated on the plans, or (2) differ materially from those generally encountered."
- "Contractor shall be reasonably compensated for site conditions that are materially different than those shown on the contract documents."

CONTRACT CLAUSES TO AVOID

- "Contractor warrants it has visited the site prior to entering this contract."
- "Owner/Architect do not warrant or guarantee the accuracy of any information concerning subsurface conditions contained in the contract documents."
- "Contractor agrees not to use any information provided by Owner, or to make a claim arising from the variance from the information provided by the Owner and the actual conditions."

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Time Extensions

ANALYSIS AND COMMENTS

Time extension provisions are important components of construction contracts. Time extensions help define the status of the project schedule, delay claims, assessment of liquidated damages, and the Owner's right to terminate. Contracts will often recognize the right to seek time extensions, but limit the Contractor's remedy solely to an extension of time. The contract should clearly define the circumstances for granting and obtaining a time extension. The work that is delayed should be compared to critical work items in order to determine the proper time extension. An Owner's refusal to grant a time extension may result in a constructive acceleration claim.

CONTRACT CLAUSES TO CONSIDER

- "Contractor is entitled to extensions of contract time for any delays beyond its control."
- "Contract time shall be extended to reflect changes in the scope of contract work."
- "Owner has the right to have other Contractors on the site, and, if there is any delay, as a result thereof, then the contract time will be extended."

CONTRACT CLAUSES TO AVOID

- "Contractor shall coordinate the work of all project parties, including parties contracted by the Owner, and Contractor shall not be entitled to a time extension for delays caused by any other party."
- "Contractor will receive a time extension only when a no cost change order is issued to the Contractor."

Arbitration/Litigation/Mediation

ANALYSIS AND COMMENTS

Arbitration and litigation procedures have respective pros and cons that must be considered before a contract is entered. Regardless of whether arbitration or litigation is selected, an intermediate step that promotes early dispute resolution should be inserted into the contract. Disputes that are left to the end of the project create adversarial positions. Early dispute resolution procedures can include a form of on-site mediation or mediation/arbitration that is triggered once a claim is filed. On-site resolution will avoid adversarial entrenchment. Contractually, joining the Architect/Engineer in any subsequent proceeding should be considered to avoid separate proceedings from progressing in separate forums with regard to the same issue. Legal fees can be reduced or avoided if early communication and resolution of disputes is required by the contract.

CONTRACT CLAUSES TO CONSIDER

- "Any and all claims shall be submitted to mediation as a condition precedent to proceeding in arbitration or litigation."
- "Owner and Contractor agree to submit any and all disputes arising from this contract to a dispute resolution panel formed by Owner and Contractor prior to the project's start."
- "Architect/Engineer shall be joined in any proceeding as a necessary party."

CONTRACT CLAUSES TO AVOID

- "The Architect/Engineer's decision shall be final with regard to any dispute or claim."
- "Owner shall select the dispute resolution procedure at the time a dispute arises."

Plans vs. Specifications

ANALYSIS AND COMMENTS

Plans and specifications are to be read together. In case of conflict, the contract can provide direction as to the interpretation of the documents. However, contract clauses establishing the priority of documents might not conclusively govern the interpretation. More specific details often take precedence over general provisions, even though a contract clause may state the contrary. In the absence of a controlling contract clause, the law will often give precedence to the more specific detail.

CONTRACT CLAUSES TO CONSIDER

- "The more specific detail will prevail."
- "In case of conflict between plans and specifications, the specifications will govern."
- "All discrepancies between the plans and specifications identified by either the owner or contractor shall be brought to the attention of the other party, in writing, in a timely manner to resolve conflict."
- "In case of a conflict, the more reasonable means of proceeding in terms of costs shall prevail."

CONTRACT CLAUSES TO AVOID

- "In case of conflict between the plans and specifications, the Contractor will perform, at its own costs, the work that is most detailed and expensive."
- "Contractor is responsible for performing all work necessary to complete the project as designed regardless of whether the work is necessitated by a conflict or lack of information contained in the plans and specifications."

Acceleration of Work

ANALYSIS AND COMMENTS

A clause allowing the Owner to direct acceleration and provide for compensation to the Contractor will require reasonable compliance by the Contractor. In other words, a Contractor cannot refuse to accelerate where the contract specifically allows the Owner to institute acceleration. This could pose a problem if the Contractor has neither the forces nor the equipment to accelerate when directed by the Owner. Before accepting an acceleration provision, a Contractor should weigh its possible ramifications carefully. When directed to accelerate, the Contractor should record all costs that are incurred as a result of the acceleration including home office staff and overhead costs.

CONTRACT CLAUSES TO CONSIDER

- "Owner shall have the right to direct the Contractor to increase its manpower and/or work hours, and owner shall compensate contractor if Contractor agrees to accelerate."
- "Contractor shall not increase its manpower at the direction of the Owner unless the direction is provided in writing and with an acknowledgement that Contractor shall be compensated for the increase and the Contractor shall not be held responsible for any damages if Contractor's reasonable efforts result in the timely completion of the project."

CONTRACT CLAUSES TO AVOID

- "Owner shall have the right to direct the Contractor to increase manpower and/or work schedules to meet established project schedules without additional compensation."
- "Owner, at its discretion, may adjust the project work schedule and any adjustment of schedule shall not give rise to a claim from the Contractor."

Work and Contract Changes

ANALYSIS AND COMMENTS

An Owner's right to require a Contractor to perform changed work, including the method of performance, should be established and defined by the contract. The scope of a change should not be infinite. Typically, changes are permitted only where it is "within the general scope of the work." A change directive may be a breach of contract if the work, means and methods of performance, or procedure are drastically altered, or if there is a "no changes clause." The contract should provide the procedural requirements (notice, written authorization, etc.) where a change affects the contract price or project duration. The Contractor may waive its right to compensation or extensions of time if it performs extra or additional work without a properly authorized change order. Change orders should include all terms, directives and conditions the parties agree to such as, but not limited to, time, cost, regional workforce increases, etc.

CONTRACT CLAUSES TO CONSIDER

- "Owner reserves the right to increase or decrease the work of the Contractor and increase or decrease the contract amount as is mutually agreed upon by the Owner and Contractor."
- "Contractor shall not perform extra work without written authorization by way of an executed change order or change directive with cost to be settled later."

CONTRACT CLAUSES TO AVOID

- "Owner reserves the right to increase or decrease the work of the Contractor and determine any increase or decrease to the contract amount it deems appropriate."
- "Contract work may be adjusted in accord with the project budget and schedule by the project Owner."

Interference with Work

ANALYSIS AND COMMENTS

Interferences may result from actions of the Owner, the Architect/Engineer or other contractors as a result of poor coordination; disruption of performance schedules; unavailability of site and work areas; defective contract documents; etc. While similar to a delay, the act of interfering with the work of another is recognized as a separate action for which a recovery may be due. A Contractor's right to a recovery is dependent upon the terms and conditions contained in its contract. Intentional and unreasonable interferences can constitute a breach of contract regardless of the provisions contained in the parties' contract. The contract should be the source for determining which interferences are compensable. Generally, interference disputes that arise between Contractors are not compensable by the Owner.

CONTRACT CLAUSES TO CONSIDER

- "Contractor shall be compensated for delays caused by Owner."
- "If Contractor's performance of work is hindered, delayed or disrupted by the actions of the Owner, Design Professional, Construction Manager, or any other party, Contractor shall be entitled to a time extension, contract cost adjustment or both."

CONTRACT CLAUSES TO AVOID

- "Owner shall not be responsible to the Contractor for delays caused by other contractors, the Owner, or any of Owner's representatives."
- "Contractor shall receive a time extension only if a work interference occurs."

Liquidated Damages

ANALYSIS AND COMMENTS

The inclusion of a liquidated damage provision has important consequences for both the Contractor and Owner. A liquidated damage provision, and “time is of the essence” provision, requires greater emphasis to be placed on the time extension provision. A Liquidated Damage provision is normally a substitute to the Owner’s right to collect actual delay damages. It represents the Owner’s attempt to quantify potential losses for delays prior to the start of the project. Liquidated damages viewed as penalties may not be upheld.

CONTRACT CLAUSES TO CONSIDER

- “Contractor shall be liable for \$___ for each day work progresses beyond the contract completion date that is a result of the Contractor’s acts or actions.”
- “Contractor shall not be responsible for any costs arising from delays to the performance of work.”

CONTRACT CLAUSES TO AVOID

- “Contractor shall be liable for \$___ for each day work progresses beyond the contract completion date.”
- “Contractor shall pay the Owner those costs set by the Owner for each day the project runs beyond the scheduled completion date.”
- “Time is of the essence, and the Contractor shall be responsible for any delays to the project schedule.”

Termination

ANALYSIS AND COMMENTS

“Termination for Convenience” and “Termination for Default” should be separate contract clauses because they refer to different events. The convenience clause permits the Owner to discontinue work without the Contractor being in default of the contract. The Termination for Convenience clause should specify the procedures by which the contract may be terminated, as well as the compensation that will be paid to the Contractor. Often, lost anticipated profits are not recoverable costs in a termination for convenience situation. A termination for convenience is not an automatic right, but must be exercised by the Owner in good faith. The Termination for Default provision should specify the conditions upon which it can be exercised. It should also contain a “correction period” to allow a Contractor an opportunity to correct the default and control their risk exposure.

CONTRACT CLAUSES TO CONSIDER

- “Owner shall have the right to terminate Contractor for failure to . . . “
- “Owner may terminate Contractor for its convenience but shall pay the Contractor for . . .”

CONTRACT CLAUSES TO AVOID

- “Owner may at any time terminate the Contractor at the Owner’s discretion.”
- “Owner may stop the project at any time without having to compensate Contractor.”

Legal Fees

ANALYSIS AND COMMENTS

Legal fees are a non-recoverable cost of arbitration or litigation unless the contract or a statute specifically provides for recovery. The potential for having to pay another party's legal fees, if you are proven to be wrong, or having acted in bad faith, will promote the settlement process. At the time a contract is executed, neither party is planning a dispute, and will therefore normally include a "never to be used" legal fee clause. Contractors should ensure that these provisions are not one sided, but equitable and fair.

CONTRACT CLAUSES TO CONSIDER

- "All legal fees shall be paid to the prevailing entity."
- "The prevailing party in a dispute shall be entitled to seek recovery of reasonable legal fees."

CONTRACT CLAUSES TO AVOID

- "Owner shall be entitled to collect attorney's fees if Owner prevails in a dispute situation."
- "Owner shall be entitled to collect attorney's fees from Contractor if Contractor fails to recover the full amount of the claim Contractor has asserted against Owner."

Defective Contract Documents

ANALYSIS AND COMMENTS

Defective contract documents may entitle the Contractor to compensatory damages for delays, extras, changes, etc. It may also relieve the Contractor from having to perform all or a part of the contract work. If defects exist, the Owner may have materially breached an implied warranty that the contract documents were suitable for construction. The key word is "materially," since minor breaches of implied warranty may not entitle the Contractor to compensation. Owners must be aware that its obligation to furnish a Contractor non-defective contract documents often exceeds the responsibility of the Architect/Engineer to provide similarly accurate documents.

CONTRACT CLAUSES TO CONSIDER

- "Contractor will be compensated for work not shown or reasonably reflected on the contract documents."
- "Contractor may claim for additional or extra work arising from defects, deficiencies or conflicts contained in the contract documents."

CLAUSES TO AVOID

- "Contractor shall review the contract documents for accuracy and conformity and notify Owner of any defects."
- "Contractor shall review the documents for conformity with applicable laws and notify Owner of any violation that may be found."

NOTES: _____



**ENGINEERING & CONSTRUCTION
RISK CONTROL DIVISION**

XL Insurance
Environmental group
505 Eagleview Boulevard
Suite 100
PO Box 636
Exton, PA 19341
Phone: 800-327-1414
Fax: 610-458-8667

www.xlenvironmental.com/icf

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