

Top 10 Contractual Risks in Construction from a Risk Management Perspective

Over the past few weeks, I posted on LinkedIn the top 10 contractual risks in construction from a risk management perspective. The following is a complete recap of the list and the associated postings.

Disclaimer: I'm not a lawyer. Although I deal with these clauses consistently while performing my job, I am not opining on anything specific. This is a general discussion only. I hope you enjoy the series, and if you have any questions about any of the items, need help with your project controls program or a troubled project, I can be reached at risk@consultaegis.com or (240) 880-4433 ext. 104.



Russell H. Wodiska
President, Aegis Risk Management

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#1: Dispute Resolution Clauses

Purpose:

All good construction contracts include a section that dictates the means, methods, and forum where dispute resolution will take place should a conflict arise. This clause establishes the rules and standards to which both parties agree to beforehand.

Importance:

Firstly, it prevents arguments about the arguments. The parties need not waste time and money battling over where or how the dispute will be resolved. Secondly, this clause provides all parties with a roadmap on how resolution can be achieved. Hopefully it promotes amicable resolution, but sometimes it makes the process burdensome and expensive. The goal is to outline a process that gives each party the opportunity to have a fair and equitable settlement.

Key Elements:

Some contractual options include mediation, arbitration, trial, Dispute Resolution Boards (DRBs), Contract Court of Appeals, or other forms of alternative dispute resolution (ADR). In many instances the process doesn't start until formal denial of a request occurs. Knowing the steps beforehand allows each party to understand risk, timing, and its potential for recovery.

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Dispute Resolution Clauses

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#2: Delay Claims / TIA Requirements Clauses

Purpose:

There's no automatic right for a party to receive delay or disruption costs. A contract must specifically allow for a party to recover damages. Fortunately, this is highly common especially in standard gov't and AIA contracts. It is crucial for parties to review the language prior to entering the contract to ensure both time extension and monetary compensation can be recovered in the event of a delay impact.

Importance:

The parties need to have a comprehensive understanding of the necessary elements to submit and justify a dispute – a court will enforce these procedures. These clauses should define what constitutes a delay and how it should be measured. Sometimes this is specific, other times more general. It also may address how to handle concurrency.

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Delay Claims/TIA
Requirements Clauses

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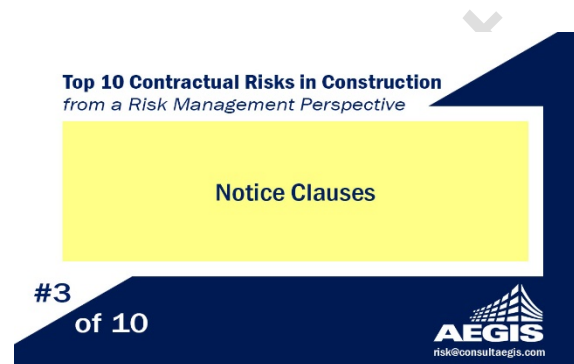
Key Elements:

Does the contract require delay to be on the critical path? Does it specify the methodology for delay claims or TIAs? Does it address concurrent delay? Are there time deadlines for delay submissions? Does it specify entitlement requirements? Does each delay need to be submitted separately? etc.

#3: Notice Clauses

Purpose:

The primary purpose of Notice Clauses is to inform and prepare all parties of upcoming issues that need to be considered. Notice of an issue is of utmost importance because it allows for critical planning BEFORE the issue begins to substantially impact the Project. In short, it allows the owner the ability to make key decisions based on the best information available.



Importance:

It is vital that all parties understand what the contract requires for effective notice procedures. Typically, a timeframe is detailed for when a contractor must provide notice of an impact (e.g., within 10 calendar days of knowledge). If a contractor fails to comply with the Notice Clause, it may fail to recover damages or additional costs associated with the impact at hand.

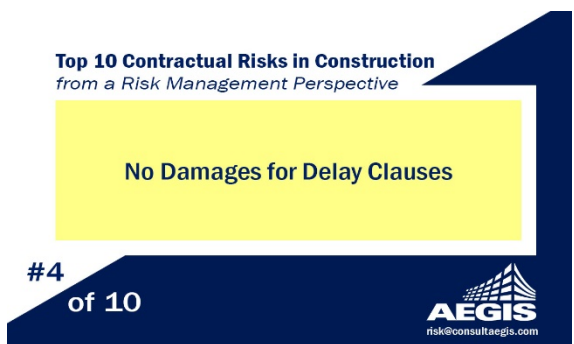
Key Elements:

How notice must be made? When must be delivered (after discovery of issue)? To whom notice must be sent? Notice is the first point of refusal an owner will (and should) use when determining if a critical impact will be compensated. By missing a deadline set forth in a Notice Clause, recovery for additional costs associated with an impact can be a legal challenge.

#4: No Damages for Delay Clauses

Purpose:

Based on their very nature, construction contracts allocate various risks to each party. No damages for delay (NDFD) clauses are used to limit the owner’s time related exposure and risks for compensating delays it causes. Contractors must account for how the NDFD is incorporated into the contract to avoid potential



contingency erosion.

Importance:

This clause is very polarizing and is not allowed in public contracts in several states. However, it is allowed in private contracts and public contracts all over the Country. Bid development must address the implications of contracts which have onerous NDFD language.

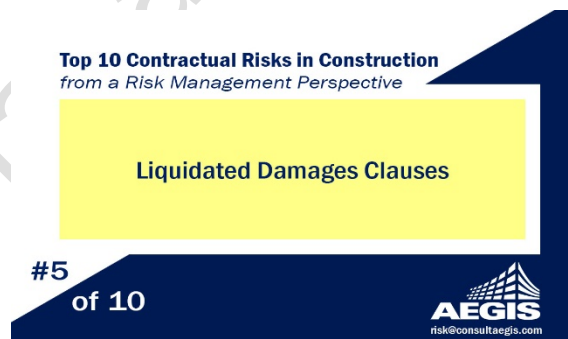
Key Elements:

When the Owner is responsible for critically delaying the Project, the contractor experiences Extended General Conditions (EGCs) costs. The ability to recover these costs are intertwined with the NDFD language. Extended contract time may be acceptable for some delays, but many require compensability. Does your bid include contingencies for EGCs which can run into months or even years when an owner is responsible for substantial critical path delays? Make sure you identify if this clause is in your contract. If it is, try to either adjust the language or modify your price accordingly.

#5: Liquidated Damages Clauses

Purpose:

This clause predetermines the amount of damages a contractor must pay should they fail to deliver the project by an established contractual date. The amount established should be a reflection of the actual losses that would be experienced if the project is delayed and should be based on a reasonable assessment.



Importance:

These clauses help the contractors/and subs understand the risk associated with not delivering the project on time. It is also used as a comparative benchmark when deciding whether to accelerate (reputation issues aside). Such clauses also eliminate the need for owners to prove the amount of the damages given a contractor delay.

Key Elements:

Owners need to make sure the amount(s) are fair/reasonable. If challenged, they can be hard to enforce if they are extraordinary or punitive. Contractors must not only know the amount (usually expressed on a daily basis, though some are applied using shorter increments), but also if they are being applied on interim milestones. In this instance check to see if they can are being applied concurrently.

#6: Force Majeure Clauses

Purpose:

Construction projects often encounter delays, and with delays come added costs. When one party is responsible for the delay, they are also liable for the associated costs or liquidated damages. But what happens when neither side is responsible for the delay? Many contracts include a “Force Majeure” (FM) clause for just this purpose.

Importance:

Force Majeure events are unforeseeable and unavoidable, often described as “Acts of God”. They include natural disasters, strikes, wars, and (sometimes) pandemics. This clause limits the liability of both parties, as neither can be held accountable for damages (i.e., non-compensable). For contractors, it provides time extensions and relief from liquidated damages. Although the event may cause financial damage it is not the responsibility of the other party.

Key Elements:

FM events are often agreed upon in advance so there is little or no debate surrounding entitlement. There may, however, be debate about the corresponding delay. For this reason, any time extension request should be accompanied by a proper schedule analysis to accurately reflect the impact. In light of recent events, make sure your FM clause includes pandemics.

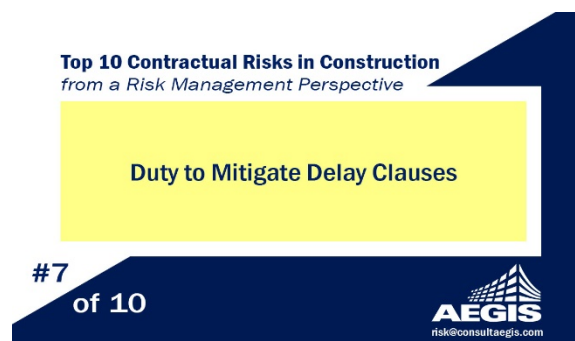
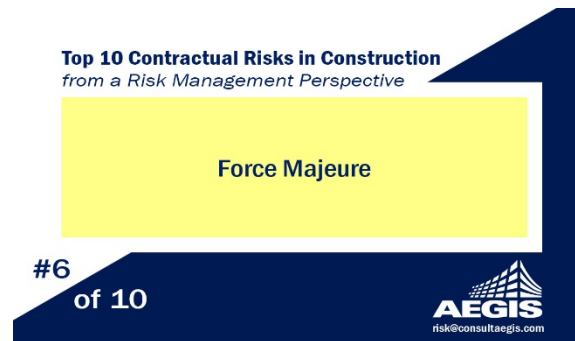
#7: Duty to Mitigate Delay Clauses

Purpose:

When a construction project encounters delays, whether the fault of the owner or the contractor, the contractor is required to minimize costs by taking reasonable steps to reduce the impacts.

Importance:

If the owner caused the delay, the contractor may be entitled to recoup additional costs from the measures taken. If the contractor is at fault, they are obligated to mitigate their own delays at their own expense. In most cases, the contractor is not entitled to any adjustment to the schedule or contract price to the extent the contractor could have taken action but failed to “reasonably” mitigate the delay.



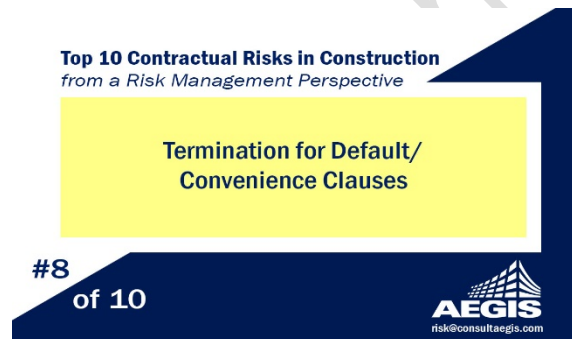
Key Elements:

Ensure a full and proper review of the language included in this clause. Does the clause require the addition of extra resources and costs? Do the requirements only extend to no-cost mitigation? What is the notice requirement that the contractor must provide to the owner prior to performing any mitigation? Note when a dispute arises related to this clause or concept (under US Common Law), typically the key is that mitigation was reasonably attempted, not that it was successful.

#8: Termination for Default/Convenience Clauses

Purpose:

Termination clauses govern the ability for an owner to cancel a contract. These clauses may dictate when, why, and how a contract may be terminated. There are two general types, Termination for Default (T4D) and Termination for Convenience (T4C).



Importance:

T4D occurs when one of the parties fail to abide by the requirements of the contract; whereas T4C gives the owner the right to cancel for any reason at any time. T4Ds often arise from poor performance, excessive delay, or failure to comply with the contract. They overwhelmingly result in formal legal action. T4Cs can be a more amenable and often result from major redesign, funding issues, or changing market conditions.

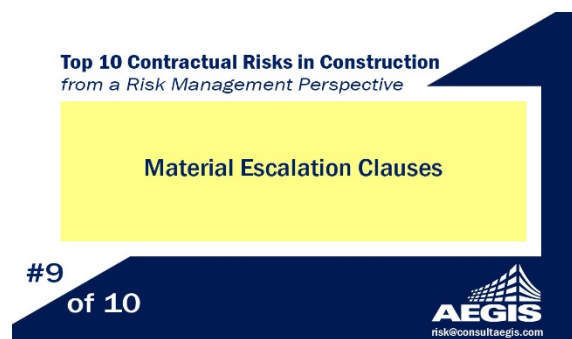
Key Elements:

All parties need to understand the elements of when, why and how they can be terminated. These may contain elements such as notice requirements, the ability to cure the default, damages in the case of default, and the right for the party to obtain payment for work, materials, and general conditions through the date of termination. T4Ds can be extremely harmful to reputation and securing future bonds, so these are often highly contentious.

#9: Material Escalation Clauses

Purpose:

In times (like now), where the price of many materials are increasing at a highly rapid pace, contractors want to ensure there is a potential remedy should one of the key components of their estimate increase considerably over the job's duration. Likewise, owners want to continue to get competitive pricing and not have the uncertainly "built in" to estimates.



Importance:

Material escalation clauses (MEC) allow the parties to adjust the price of materials based on an agreed upon metric. This could be, “when the price of an item increases by X% from contract date to installation”. Although called an “escalation” clause the concept can provide savings if also written to address decreases.

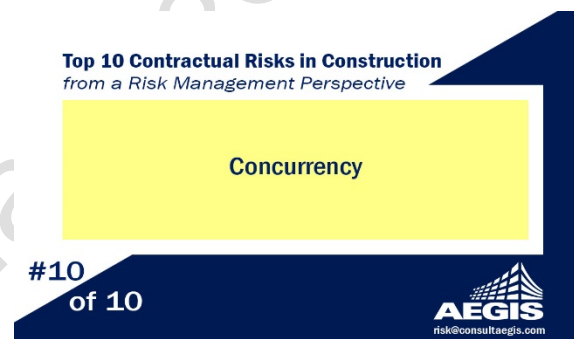
Key Elements:

Check that your contract has a MEC in place, many do not. For new contracts insert and make sure the % over/below the estimate is reasonable. Does the increase have a cap on it? Is it only for specific items, or any material, equipment, or energy? What substantiation is required? If your contract does NOT contain a MEC you may be able to seek relief under the Force Majeure cause, or through an REA based on “commercial impracticality”.

#10: Concurrency Clauses**Purpose:**

Concurrency can sometimes be included within other clauses and not as a standalone. More and more frequently, however, references to concurrency are appearing in contracts.

Overwhelmingly, owners are trying to shift risk of compensable delay to contractors. This occurs even when not in contracts, but by including it upfront the parties at least know the expectations and can bid accordingly (or make edits to align with bid).

**Importance:**

The amount of compensable delay for a contractor can be radically altered depending on how concurrency is defined. Typically, owners define it using a “functional” approach (as opposed to a “literal” approach) which often creates ambiguity and a more loose interpretation.

Key Elements:

Under the functional approach, delay need not be on the critical path but can exist on secondary, tertiary, or even on later float paths. It is important to understand how concurrency is to be measured, and if it applies to BOTH parties. In other words, are liquidated damages removed if the owner has a concurrent issue to a contractor caused delay? Often not, so be careful with this one!