I. Overview of Construction Claims

A. Two Primary Types of Contractor Claims – But Substantial Overlap

1. Non-Time Related Claims – Claims which seek cost (and usually profit and overhead) to perform changed scope-of-work due to directed and constructive changes.

2. Time Related Claims
   a) Delay

   Excusable – Excusable delays are those delay-causing events that are unforeseen and outside the contractor’s control. Contractor is typically entitled to time extension and possibly extra compensation.

   Non-Excusable – Any delay owing to the fault of a contractor or its subcontractors which does not merit extra compensation or time extensions.

   Compensable – Delays which are caused by the owner or the owner’s representatives which entitle contractor to receive extra compensation in addition to time. Common owner caused delays include: lack of access; failure to obtain permits; defective plans or specifications; failure to respond to contractor submittals.

   Concurrent Delay – Two or more delay-causing events by more than one party which occur at the same time and overlap. Often used as a defense by owners in the face of contractor delay claims.

   b) Disruption – An event that increases the cost of performance but does not necessarily delay the whole project. Disruption is also referred to as hindrance or interference. Most disruption claims are brought by contractors alleging that acts on the part of owners have impeded their ability to perform the job in an efficient manner.
c) Acceleration

Directed – Owner requires contractor to complete all or a portion of the job prior to originally scheduled completion date.

Constructive – Contractor must complete project without an adjusted progress schedule when the owner wrongly refuses to grant a time extension for an excusable delay.

B. Claims Can Also Be Characterized By The Type Of Damages Being Sought

1. Hard Costs – Usually easy to resolve.
   a) “Actual” cost of labor, materials and equipment to perform out-of-scope work plus usually overhead and profit.
   b) The two most common disputes concerning a “hard cost” claim involve (i) whether or not the owner is responsible for the alleged out-of-scope work, and (ii) the “pricing” methodology to be used.
   c) Spearin Doctrine – An owner impliedly warrants that owner-issued plans and specifications are free from defect and that the project can be constructed from those plans and specifications. U.S. v. Spearin, 248 U.S. 132 (1918). As such, contractors can typically recover extra costs incurred to overcome design defects. See also Tonkin Construction Co. v. County of Humbolt, 188 Cal.App.3d 828 (1987).

2. Soft Costs – Disputes involving soft costs are usually more difficult and complex than those involving hard costs because recovery of costs often entails the use of experts and complicated economic formulae.
   a) Inefficiency/Disruption Costs – Various methodologies including measured mile, industry studies, and other “creative” economic equations.
   b) Overhead
      (1) Jobsite overhead
      (2) Unabsorbed Home Office Overhead (aka Eichleay damages based upon Eichleay Corp., ASBCA No. 5183, 60-2 B.C.A. (CCH) ¶2688) – Typically, in order to recover home office overhead under a federal construction contract, the contractor must show that there was a government imposed delay, that the contractor was required to stand by during the delay, and that while standing by it was unable to take on additional work. See Sauer, Inc. v. Danzig, 224 F.3d 1340 (Fed. Cir. 2000).
   c) Lost profits and loss of bonding capacity – Can usually be defeated by excluding consequential damages in the contract.
II. **What To Do To BEFORE WORK BEGINS**

A. Many disputes and claims can be avoided or at least minimized by planning, open communication, and careful drafting of the construction contract.

B. **Planning And Open Communication** – Owners should invest more resources in the design and engineering process to resolve problems during the pre-construction phase. Moreover, Owners should provide complete and up to date information concerning site conditions and project requirements so as to allow contractors to more accurately bid on a project – this also has the added benefit of shifting risk to the contractor and preventing a “Superior Knowledge” claim.

C. **Partnering/Team Building** – Partnering is an increasingly common method to facilitate communication between the various parties involved in a construction project in order to reduce disputes and boost productivity. The various participants in a construction project create a process that will allow the parties to work in a non-adversarial manner.

1. Prerequisites for Successful Partnering – Commitment by management to the partnering process; mutual trust; open communication; shared responsibility for successes and failures; and common goals.

2. Formal Structure (not always necessary)
   
a) Workshop
   
   (1) Participants – Ideally, every party that could materially impact the cost, time, quality or safety of the project should be represented at the workshop.

   (2) Facilitator – Neutral third party to conduct the workshop so as to create an atmosphere for team building. The facilitator should have experience both in the construction industry as well as in the area of group dynamics.

   (3) Purpose - The workshop serves two primary functions: to foster relationships of trust between the parties, and to create a mechanism for solving problems or disputes that may arise during the course of the project.

b) Charter – Memorializes the consensus reached in the workshop. The charter should avoid being overly specific and detailed. Rather, the charter should reflect the shared vision and common goals of the workshop participants.

3. Concerns

   a) The charter is not intended to be a legally binding contract and care must be taken to avoid it supplanting the project contract in the minds of the participants. Creative lawyers sometimes allege that the “charter” creates a fiduciary relationship between the parties.
b) Partnering is not a panacea, but rather it is simply a way to build an atmosphere of teamwork and trust. Beware that when a significant dispute arises, parties often ignore partnering principles and proceed based solely upon their own self-interest.

D. Project Delivery Systems – Varying Degrees of Risk


2. Design-Build – Contractor performs both the design and construction functions on a project through the use of architects/engineers who are in-house employees or independent contractors. Alternatively, owners may contract with joint ventures formed by contractors and design professionals.

a) Advantages

(1) Early commitment to final construction cost.
(2) Risk from design defects is shifted to the contractor.
(3) Contractor has control over entire construction process, which results in increased efficiency and can facilitate fast-track construction.
(4) Single contract is easier for owner to manage, streamlining communications and reducing paperwork.

b) Disadvantages

(1) Owner can lose input in the design process.
(2) When the contractor uses design professionals who are independent contractors, the responsibility of the architect/engineer to the owner is undefined given that there is no direct contractual relationship between them.
(3) Many contractors are adverse to design-build process, thereby reducing supply of available contractors.
(4) Allocation of responsibility is sometimes blurred when owner develops partial or conceptual design, but contractor is asked to accept responsibility for entire design.

E. Pricing Methods for Construction Contracts – Varying Degrees Of Risk

1. Fixed-Price/Lump-Sum Contract – Stipulates a price for which the contractor will perform the work under the contract. The contractor assumes the risk of
any additional costs required to complete the project. However, the contractor also has the potential to realize greater profit if it can reduce costs.

2. Cost-Plus Contract – Contractor is paid for the cost of labor and materials plus a fixed amount that represents profit and overhead. A pure cost-plus contract provides little incentive for the contractor to hold down costs and the owner assumes most of the risk for most cost overruns. KEY: Make sure definitions of allowable and non-allowable costs are precise – otherwise, disputes are likely to occur.

3. Guaranteed Maximum Price (GMAX) Contract – The contractor agrees to perform the work on a cost-plus basis, but a not to exceed guaranteed maximum price is established as a ceiling. Often these contracts provide incentives to contractors, either in the form of a flat fee or a percentage of realized cost savings, to perform the work for less than the guaranteed maximum price.

F. Contract Clauses – It is important to conduct a detailed review of the contract documents including the general and special conditions. Many opportunities to allocate risk are missed because parties to a contract rely upon “boilerplate” language rather than tailoring the documents to address the peculiar risks created by specific projects.

1. Scope of Work – A clearly defined scope of work is critical to determine the contractor’s obligations.

2. Time of Performance – Establish a clear time for commencement and completion of the project.

3. Payment

   a) Given that many construction disputes center on payment issues, it is important to have a well-drafted payment provision that clearly states the procedure the contractor must follow when applying for progress payments and final payment.

   b) The owner needs a sufficient period of time to review the pay requests and related documentation submitted by owners.

   c) Always insist on a reasonable retention amount (usually 10%).

   d) Make sure that the “schedule of values” is based upon reality so that the contractor is not overpaid for work performed. Avoid front-end loading.

4. Pre-Construction Inspections And Evaluation

   a) Typical Clause

   The Contractor represents that it has visited the Project site, has examined carefully all of the Contract Documents, has reviewed all reports, surveys, test data and other information relating to the conditions at the Project site
that have been identified to the Contractor by the Architect or Owner in connection with the solicitation or submission of the Contractor’s bid and the negotiation of this Contract, has made a reasonably thorough inspection of the Project site (during which inspection the Contractor has correlated its personal observations with the requirements of the Contract Documents and has acquainted itself with all observable conditions under which the Work will be performed) and has acquainted itself with all other observable conditions relevant to the Work. Based on the foregoing, the Contractor assumes responsibility for, and all risk in connection with (and shall not be entitled to any increase in the Contract price or time or any other damages or additional compensation based on), any conditions at the site about which the Contractor reasonably should have known based on the information and testing made available to the Contractor by the Owner prior to the execution of this Contract (including a reasonably thorough inspection of the Project site).

b) Shifts risk of liability to contractor for errors, omissions, inconsistencies and site conditions that the contractor knew about or should have known about given the document review and site inspection. See Umpqua River Navigation Co. v. Crescent City Harbor District, 618 F.2d 588 (9th Cir. 1980) (Contractor not able to recover for increased dredging costs when site inspection and bidding materials alerted or should have alerted contractor to adverse soil conditions).

5. Authorized Representatives – Designate the specific individuals (by name) who will be authorized to speak and act for the contractor and the owner. This prevents confusion by eliminating a situation where multiple individuals provide conflicting information and directives.

6. Means And Methods – It is important to confirm that the contractor is solely responsible for the means, methods, techniques and procedures for construction. This type of clause helps clarify the respective roles of the owner, designer and contractor, and may prevent a claim by the contractor that “the owner told me to do it this way.”

7. Notice And Claim Resolution Requirements – Require contractor to promptly provide notice of an event giving rising to a claim and follow a specified dispute resolution procedure. A contractor’s failure to comply with these requirements MAY result in waiver of the contractor’s claim.

a) Typical Clause

Contents Of Claim: A claim must include the following: (i) a statement that it is a Claim and a request for decision pursuant to this Article of this Construction Contract; (ii) a detailed description of the act, error, omission, unforeseen condition or other condition or event giving rise to the Claim; (iii) if the Claim seeks additional compensation, a detailed breakdown of all amounts being claimed; and (iv) if the Claim seeks a time extension, written documentation demonstrating the Contractor’s entitlement to a time extension.
Time Limits on Submitting Claims: **Claims must be submitted to Owner [or Architect] within twenty-one (21) days after occurrence of the event giving rise to such Claim or within twenty-one (21) days after Contractor first recognizes the condition giving rise to the Claim, whichever is later.** Contractor agrees that strict compliance with the requirements of this Paragraph is an express condition precedent to Contractor’s right to litigate a Claim in a court of law.

**Final Decision of Owner:** Owner shall timely review Claims submitted by Contractor. If Owner determines that additional supporting data are necessary to fully evaluate a Claim, Owner will request such additional supporting data in writing, and such data shall be furnished no later than ten (10) calendar days after the date of such request. The decision of the Owner shall be final and binding unless appealed in accordance with the following paragraph.

**Appeal of Final Decision:** If Contractor disputes the final decision of the Owner, Contractor shall have the right, within ninety (90) calendar days after the final decision is issued, to commence litigation against Owner in a court of law. If litigation is not commenced by Contractor within ninety (90) calendar days after the final decision is issued, the final decision on the Claim shall be final and binding and not subject to appeal or challenge.

**Continuing Contract Performance:** Contractor shall diligently carry on the Work in accordance with the approved schedule during the pendency of any Claim or during any litigation proceeding.

b) Some courts will not strictly construe contract notice and claim provisions absent prejudice by the owner. See Nat Harrison Assocs., Inc. v. Gulf States Util. Co., 491 F.2d 578 (5th Cir. 1974) (Waiver of notice provision for additional cost claims where owner was aware of additional costs and did not object). **KEY:** Have a clearly worded notice and dispute resolution clause with specific waiver language.

c) The architect is often used in a quasi-judicial role as the first layer of review, and in some instances the parties agree that the architect’s decision is binding. In this role, the architect is supposed to be neutral, and the architect may be conferred with quasi-judicial immunity from honest mistakes. See E.C. Ernst, Inc. v. Manhattan Constr. Co., 551 F.2d 1026 (5th Cir. 1977), opinion modified, 559 F.2d 268 (5th Cir. 1977) (holding that immunity only applies when architect’s “action is functionally judge-like”).

8. **Waiver By Final Payment** – Claims can be limited by including a provision that makes final payment the event that cuts off the further assertion of claims.
a) Typical Clauses:

Waiver By Contractor: Acceptance of final payment by the Contractor . . . shall constitute a waiver of claims except those previously made in writing and identified as unsettled at the time Contractor submits its final application for payment.

Waiver By Owner: The making of final payment by Owner shall constitute a waiver of Claims by the Owner except those made in writing and unsettled and identified at the time of final payment [other exceptions: warranty claims, latent defects, etc.]

b) Courts do not like waiver and forfeiture clauses, but waiver by final payment provisions are often upheld when the language is clear and precise – especially if the claimant knew of the problem when final payment was made. See Renown, Inc. v. Hensel Phelps Construction Co., 154 Cal. App.3d 413 (1984) (Owner waived defect claim by making final payment where defects were apparent at time payment was made); APAC-Carolina, Inc. v. Town Of Allendale, et al., 868 F.Supp. 815 (D.S.C. 1993), aff’d 41 F.3d 157 (4th Cir. 1994) (contractor waived claim for additional compensation by accepting final payment).

c) Exceptions can be added to the waiver provision to allow various types of claims to be brought after final payment.

9. Liquidated Damages

a) Provide an incentive to contractor to perform project in a timely manner, and provide owners with a means by which to avoid the difficulty associated with delineating and proving damages. However, beware that owner’s actual damages might vastly exceed the agreed upon liquidated damages.

b) Enforceability – Liquidated damages clauses are generally enforceable as long as damages were impracticable or difficult to ascertain and the sum agreed upon represented a reasonable endeavor to ascertain what damages would be. See California Civil Code § 1671. Courts may refuse to enforce a liquidated damages clause if the award of the specified damages would constitute a penalty or if the delay was caused by the mutual fault of the owner and the contractor. See General Insurance Co. v. Commerce Hyatt House, 5 Cal.App.3d 460 (1970).

c) Owners and contractors should consider including a reciprocal liquidated damages provision whereby the contractor would be able to collect liquidated damages for delays caused by the owner. These clauses are not common, but they help avoid contentious litigation concerning the calculation of a contractor’s delay damages. Moreover, contractor’s often agree to a small number (below cost) to obtain a significant project.

10. Scheduling – A critical path activity is one that, if allowed to grow in duration, will increase the overall time required to complete the project. By contrast, an
activity with float time may grow in duration up to a certain point without an adverse impact on the time required to complete the project.

a) The contract should state that only critical delays are excusable and/or compensable.

b) The contract should also identify the party who will get the benefit of any float in schedule.

c) Owner should require contractor to submit updated schedules on a regular basis and to identify delays on a forward-looking basis. This will identify problems when they arise and also prevent a creative scheduling consultant from manipulating the schedule after the fact.

11. No Damage For Delay Clause

a) Typical Clause

If the Contractor is delayed in completing the work due to a cause or causes attributable to Owner, or events outside the reasonable control of Contractor and its subcontractors, the Contractor’s sole remedy shall be to obtain an extension of the time for completion of the work commensurate with such delay. Under no circumstances shall Contractor be entitled to additional compensation as a result of any delay in completing the Project.

b) No Damage For Delay clauses have been held to be enforceable in many situations. See K&F Construction v. Los Angeles City Unified School District, 123 Cal.App.3d 1063 (1981).

c) However, because No Damage For Delay clauses can result in forfeiture and severe hardship, they have been legislatively banned in certain instances, and such clauses are always strictly scrutinized by courts.

(1) For example, California Public Contract Code section 7102 bars such clauses where a public owner has caused a delay that is unreasonable and not within the contemplation of the parties. See also Howard Contracting, Inc. v. G. A. MacDonald Construction Co., 71 Cal.App.4th 38 (1998).

(2) Some jurisdictions will not enforce no damage for delay clauses in the following situations: (a) the owner willfully or maliciously caused the delay; (b) the delay was not contemplated by the parties; (c) the owner’s delay was so unreasonable as to amount to abandonment of the contract; and (d) the owner’s breach of a fundamental obligation in the contract caused the delay. See Corrino Civetta Const. Corp. v. City of New York, 502 N.Y.S.2d 681 (1986).

12. Indemnity – The contract should include a strong indemnity clause requiring the contractor to indemnify the owner against all claims arising from or related
to the contractor’s work, as well as all claims by subcontractors, suppliers, employees, agents, etc.

a) If possible, get a Type I indemnity clause which creates an indemnity obligation even if the Owner was partially negligent. The following is a typical Type I indemnity clause:

Contractor agrees to indemnify, defend and save harmless Owner from and against any and all claims, suits, causes of action and damages of any kind arising out of or in any way related to the performance of the work by Contractor, including claims, suits, causes of action and damages which involve the active or passive negligence of Owner. [This Section shall not indemnify Owner from loss, damage or expense caused by the sole negligence or willful misconduct of Owner.]

b) In some jurisdictions, a contractor cannot indemnify an owner for the liability resulting from the owner’s sole negligence or willful misconduct. See California Civil Code § 2782.

c) At a minimum, make sure that contractor must accept the defense and indemnity of all lien, stop notice and bond claims by subcontractors and suppliers.

13. Change Orders Process

a) There should be a clearly defined process for handling change orders, including delineating the type of information that must be contained in a request for change order.

b) Establish a change order process that incorporates predetermined formulas to value such items as overhead, profit and similar charges.

c) Pricing is usually based upon: mutual acceptance of a lump sum; unit pricing; cost plus overhead and profit.

14. Bonding

a) The owner should require performance and payment bonds on ALL projects – even if the cost of a bond is passed on to the owner.

b) In some jurisdictions, if the owner records the payment bond, the rights of lien and stop notice claimants are severely limited. See California Civil Code §§ 3162, 3235 – 3236.

15. Insurance

a) Liability insurance – The contractor should be required to maintain sufficient liability insurance in the event of a third party claim, and the owner should be listed as an additional insured.
b) All risk/property insurance – Contract needs to specify who is responsible for insuring work before completion from perils such as fire, flood, earthquake, vandalism, theft.

16. **Alternative Dispute Resolution** – We recommend that contracts provide for some form of alternative dispute resolution (ADR) to resolve disputes. The parties may choose to include more than one form of ADR. Moreover, the parties may create a progressive structure whereby one method of ADR must be exhausted before proceeding on to the next level.

a) Mediation

b) Arbitration (vs. litigation)

c) Dispute Review Boards (DRBs)

   (1) DRBs are created to address problems as they arise during the course of a project. As such, DRBs can provide relatively quick decisions that prevent prolonged delays and can diffuse other problems that would have arisen further on down the line.

   (2) DRBs are typically made up of one or three neutral experts in construction.

   (3) After a hearing regarding the dispute, the DRB panel typically issues a nonbinding decision – although the decision can be binding.

17. **Waiver Of Contractor’s Consequential Damages** – The inclusion of a properly worded “waiver of consequential damages clause” clause will likely defeat a claim for lost profits.

18. **Flow-Down Requirement** – In order to protect against subcontractor claims, contract should require contractor to flow-down key clauses to subcontractors.

19. **Attorneys’ Fee Clause** – An attorney’s fee clause can be used to deter frivolous claims before litigation, and it may allow prevailing party to recoup substantial costs if litigation is necessary.

20. **Audit Clause** – Make sure the Owner has a right to audit the contractor’s financial and project records – even if the contract has a firm, fixed price. Owner can use this clause as an informal discovery device for various purposes.

### III. What To Do AFTER WORK BEGINS

#### A. Open Communication And Partnering

1. Adopt a person-to-person mode of communication to discover and address problems and questions that arise during a project.
2. Regularly scheduled meetings are usually more effective than conducting a battle of correspondence.

3. Employ “partnering” principles.

B. Record Keeping

1. Accurate records must be kept in case a dispute arises.

2. Prepare accurate and complete meeting minutes and distribute to the contractor so as to require him to object or accept the contents of the minutes. These are invaluable in subsequent litigation.

3. Your employees need to be VERY CAREFUL not to make harmful admissions in external and internal documents and e-mail – litigation is often won or lost based upon careless admissions.

4. Avoid inflammatory language.

C. Enforce the chain of authority specified in contract. Make sure your employees do not create constructive changes by making casual remarks during construction.

D. The owner or owner’s representatives should promptly respond to all submittals as soon as reasonably possible. Contractors often assert that an owner’s late response to submittals delayed completion.

E. Actively review schedules on a going-forward basis to identify problems as they arise. Do not let a creative scheduling consultant develop a “make-believe” critical path after the project is completed.

F. Inspect carefully and thoroughly, but do not direct the contractor how to do its job. The contractor is responsible for “means and methods,” and invading into the contractor’s realm can lead to a claim. Also, “over-inspection” can lead to a disruption/interference/lost productivity claim.

G. Change Orders

1. Promptly resolve and accurately record change orders.

2. Do not sign change orders that leave open issues.

3. Include broad release language in change orders.

4. Retain counsel on significant change orders.
H. Insist upon the contractor’s strict compliance with payment provisions, including the submission of lien releases from subcontractors and suppliers.

I. Audit – Take advantage of the audit clause in every case. A contractor’s refusal to permit an audit is arguably a breach of the contract.