

Project Contracting

THOMPSON
HINE



Major Risks and Negotiation Strategies

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Session Objectives

1. Understand Key Clauses
2. Develop Negotiation Strategies
3. Discuss Best Practices
4. Open Question & Answer Session





Key Project Risks

1. Budget
2. Schedule
3. Performance / Quality



Contract Clauses - Overview

- **Payment Terms:** Lump Sum v. Open Book
- **Delays:** Liquidated Damages, Consequential Damage Waiver
- **Indemnity:** Third Party Claims, Negligence Based and Insurability
- **Warranty:** Timing, Performance Guarantees (LDs), Scope
- **Insurance:** Typical Limits, Additional Insured Status
- **Termination:** Convenience/Default, Notice and Cure
- **Disputes:** Litigation v. Arbitration, Choice of Law and Venue



Payment Terms - The Basics

Watch Out – Prompt Payment Acts – State to State

- ✓ **Price** – includes all costs for the project, tied to a defined scope
- ✓ **Trigger** – “after approval”
- ✓ **Timing** – advance payment, installment milestones, 30 days
- ✓ **Backup Requirements** – lien waivers and pay application forms are typical – receipts and payrolls are not required on lump sum projects
- ✓ **Approvals** – Owner, landlord, tenant, lender, others?
- ✓ **Retainage** – 5-10% is typical
- ✓ **Withholding and Offset** – for defective work, other problems
- ✓ **Interest** – “pre-judgement” (6-12%) or “prompt pay” (usually higher)



Pricing Options Workshop

Lump Sum

- Fixed Price
- Closed Book, No Audit

Time & Materials

- No Cap
- Open Book with Backup

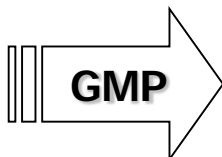
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- Not-to-Exceed Cap
- Open Book, Robust Audit

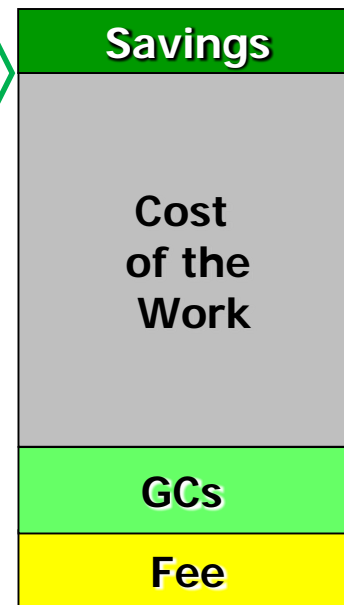
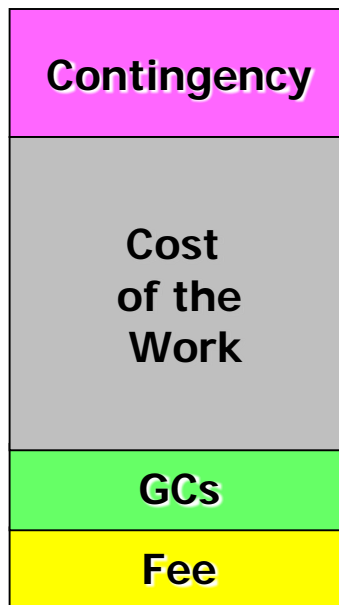


Pricing Options – Lump Sum vs. GMP Approach

Lump Sum Contract



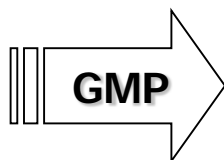
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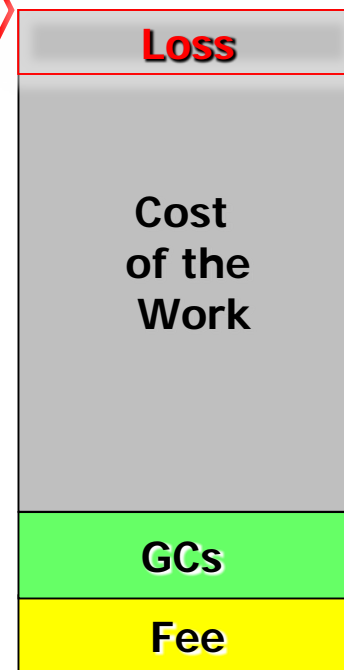
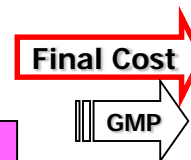
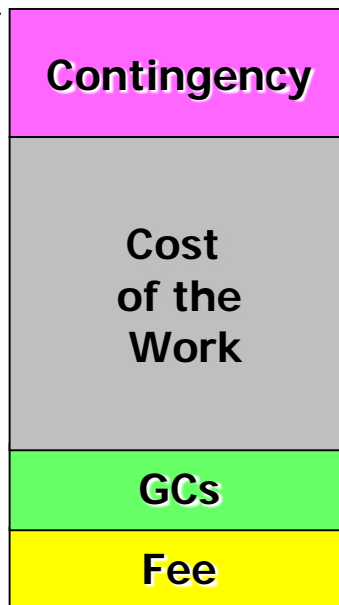


Pricing Options – Lump Sum vs. GMP Approach

Lump Sum Contract



GMP Contract





Delays and Delay Damages

■ 3 Types of Delays



1. **Excused / Compensable: Time + Money**, *Owner* Caused or Control
 - ▣ Interference, owner changes, suspension of work, etc.
2. Excused / **Non-Compensable: Time Only**, No One's Fault
 - ▣ Force Majeure, Acts of God, Fire, Labor Disputes, etc.
3. **Unexcused: Damages**, *Contractor* Caused or Control
 - ▣ Failure to manage project, subcontractor default, corrective work, etc.



Consequential Damages

■ Two Types of Damages

- Direct Damages: follow naturally and necessarily from the contractor's breach and are reasonably foreseeable at the time of contracting
- Consequential Damages: more attenuated, these are damages that flow from the consequences of the contractor's actions, such as lost profits or adverse effects to business reputation

■ Consequential Damages are...

- Unforeseeable & Excessive (risk is grossly disproportionate to fee)
 - Example: *Perini Corp. v. Great Bay Hotel & Casino, Inc.* Contractor hit with \$14,500,000 judgment for consequential damages - 25x its Fee!!
- Usually Waived in Contract



Liquidated Damages Clause

■ Alternate Remedy for **Contractor**-Caused Delay (**Unexcused**)

- ▣ Delay Damages are Hard to Estimate, Uncertain, Catastrophic
- ▣ Owner Needs Protection for Unexecuted Delays
- ▣ Parties can “Liquidate” Delay Damages to a Reasonable Amount
- ▣ Thus, LDs are “in lieu of” Actual Damages

■ Calculation Options: Lump Sum, Daily Rate, or Combination

If the date of Substantial Completion of the Work occurs after the Guaranteed Substantial Completion Date, as that date may be extended pursuant to the terms of the Contract Documents, then Contractor shall pay to Owner (by direct payment or offset from the Contract Sum) the following: **(a) a lump sum amount of _____ Dollars (\$_____); and (b) _____ Dollars (\$_____)** per day through **and including the date when Substantial Completion of the Work actually occurs** (collectively, the "Substantial Completion LD's").



Liquidated Damages Clause

■ Risks To Owner

- ▣ LDs are too low, overexposed to Contractor-caused delay
- ▣ Contractors increase their bid to account for LDs

■ Best Practices

- ▣ Ensure LDs bear relation to actual damages (consider and calculate)
- ▣ Alert bidders early if LDs will be used

■ Negotiation Tips

- ▣ Cap: Usually a percentage of the Fee ($\frac{1}{2} > 1x > 2x$)
- ▣ Grace Period: Resist, include the float in the schedule
- ▣ Early Completion Incentive: Evaluate, does it make sense based on the schedule?



Consequential Damages Workshop

The **Contractor and Owner** waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes, **without limitation**: [**Typical CDs**: (1) damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and (2) damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.]

■ Typical Requested Carve Outs

- Liquidated Damages
- Fraud, criminal actions, willful misconduct
- Intellectual property infringement
- Violation of confidentiality obligation
- Violations of applicable law
- Covered by Insurance
- [Third Party] Indemnity Claims
- [Gross] Negligence



Indemnification – The Basics

- **Definition:** A contractual indemnification is where one party (Contractor) takes responsibility for claims made against another party (Owner). ***Third Party Protection***
- **Limitations:** Many jurisdictions *prohibit* forcing a Contractor to indemnify an Owner for its own negligence. Some, though, permit it based on “freedom of contract” principles.
 - ▣ **The “Limited Form” Clause:** Contractor indemnifies Owner only *to the extent* of Contractor’s negligence. Fair and balanced.
- **Duty to Defend:** Separate from “indemnity” obligation. The “defend” obligation requires upfront defense vs. indemnifying for attorneys’ fees on the backend.



Indemnity Clause Workshop

AIA A201 § 3.18: To the fullest extent permitted by law the Contractor shall indemnify, defend and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder.



Warranty – The Basics

- General Warranty vs. Corrective Work Period
- General Length – depends on lots of variables
 - ▣ 1-2 years is common, but insurance may be maintained longer
- Negotiation Tips
 - ▣ Written Notice and Opportunity to Correct
 - ▣ Owner’s Right to Repair if Contractor Fails
 - ▣ Exclusions: improper operation, normal wear and tear, etc.
 - ▣ **Danger** - watch out for “sole and exclusive remedy” language



Performance Guarantees / LDs

- **There is no one-size-fits-all clause.** Equipment is unique.
- **Considerations**
 - ▣ Performance Requirements / Parameters
 - ▣ How do you measure “successful” performance?
 - ▣ Performance Tests / Measuring
 - ▣ Who performs the tests? How many times do you run them?
 - ▣ Consequences of Failure
 - ▣ What happens if the equipment fails?
 - ▣ Remedies – LDs v. Actual Damages



Insurance

■ Standard Types and Limits

- ▣ **CGL:** \$1/\$2M, excess \$5M
- ▣ **Professional:** \$1/\$2M, up to \$5M
- ▣ **Builder's Risk:** By Owner

■ Additional Insured Status

- ▣ **Included:** CGL, Auto, Excess
- ▣ **Not Included:** Professional
- ▣ **Purpose:** Make a claim directly for insurance coverage. Backstop for indemnity obligations.

■ **Certificate of Insurance (COI):** Make sure it matches contract.



Termination

- **Termination for Default:** Generally not controversial. Mutual.
- **Termination for Convenience:** Very important for Owner.
 - ▣ Need the option in case market changes, ownership changes, business needs change, etc.
 - ▣ Be fair to the contractor. Pay them for actual, direct, unavoidable costs resulting from the termination. In other words, “make them whole” if owner terminates without cause.
 - ▣ Do not give them a windfall. There is no termination “fee” or payment for unearned overhead and profit.
- **Notice and Cure:** Reasonable timeframes – 10 day or 30 day.



Disputes

■ Litigation v. Arbitration

- ▣ **Industry Practice:** Varies, trend toward arbitration
- ▣ **Tips:** Arbitration is private, but litigation is more predictable

■ Choice of Law / Venue

- ▣ **Industry Practice:** State where project is located
- ▣ **Tips:** Try for venue in home jurisdiction, particularly if using arbitration. Choice of law typically must be place where project is located. Check local laws.



OPEN Q&A



Thank You!

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