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Deconstructing the Construction Contract

By Raul Alvarez

Construction contracts represent the agreements and resulting expectations of the numerous kinds of parties that undertake construction projects. They are crafted to avoid disputes, but disputes arise from payment issues, errors and changes in plans, delays, defects, property damage, worksite injuries and a slew of other risks. After all, construction projects call for the collaboration of multiple entities, each with its own personnel and each person with their own understanding of the project. The potential for conflict is ever-present.

Prudent owners, developers and contractors alike do everything they can to prevent costly litigation. While impossible to entirely prevent all mishaps and disputes, establishing a construction contract that covers the legal bases and addresses foreseeable potential conflicts is the starting point of a sensible project.

There are several kinds of construction contracts that address varying fundamental factors at the project's outset, like whether design will overlap with construction and how many contractors will be involved.[1] There are lump sum contracts, fast track contracts and design-build contracts, to name a few.[2] The American Institute of Architects, or the AIA, offers form contracts that are accepted as industry standards nationally for virtually any kind of construction project.[3] Using a form or not, parties must understand each provision in the construction contract to which they legally bind themselves. This article discusses provisions found in nearly every construction contract that are essential in addressing disputes and avoiding litigation.

Project Description (Scope of Work)

Project description provisions are critical. Parties with longstanding relationships sometimes rush to put *anything* in the contract just to charge into the project with an informal understanding of the details. Legally though, service providers are contractually bound to perform within the scope of work. Throw in a standard integration clause, and an owner or developer may find it challenging to

EDITOR'S NOTE: For practitioners who need to draft or review a construction contract, this handy primer reviews a number of standard provisions and suggests strategies for avoiding litigation.

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convince a court that they meant more than what was written.

Using contract interpretation principles, courts interpret scope of work provisions literally, such as in *All Year Cooling & Heating, Inc. v. Burkett Properties, Inc.*[4] There, an owner sued an air conditioning contractor because the contractor did not bring the building's two existing air conditioning units up to code, pointing to a provision requiring code compliance for all the building's air conditioning units.[5] The scope of work provision, however, required that the contractor install six new air conditioning units, and that the two currently existing units were "working perfectly" and "not to be replaced as part of this contract."[6] The Fourth District took that to mean that the existing units were excluded from the scope of work and not encompassed by the code compliance provision, holding for the contractor.[7]

Parties are accordingly wise to craft these provisions with as much detail as possible as to what is (and is not) required. One way contractors can represent their understanding of the project is to incorporate their bids and proposals into the scope of work by reference. In practice, most scopes of work for major projects are incorporated by reference from detailed plans, materials lists, bid documents and other building standards. Parties ultimately must strive for unequivocal agreement and understanding of the scope of work to avoid future problems. If they sense a gray area, the best practice is to address it as specifically as possible in as many words as it takes.

Developing a detailed construction contract can go a long way in avoiding litigation and allowing the parties to have peace of mind.

Timeline

Parties must plan work for projects in deference to strict start and completion dates, specific milestones, and the schedules of often several contractors. A detailed timeline ensures that all stakeholders are on track to complete the project on time. A typical commercial construction project can include phases for design, bids, contracts, permits, inspections, site preparation, foundation, roof exterior finishes, plumbing, electrical, HVAC, insulation, drywall, interior finishes, painting, flooring, fixtures, appliances, landscaping, and final completion. All those phases depend on each other to function within a carefully designed plan, deviation from which can lead to significant costs.

When contractors are responsible for inexcusable delays, they commonly are subjected to pre-negotiated liquidated damages included in the construction contract. These damages take the form of specific dollar amounts assessed against the contractor for each day of delay.[8] Conversely, contractors protect themselves from delays by including enforceable "no damage for delay" provisions in construction contracts.[9] With these, parties are not liable for delay damages except when their delays arise from fraud, bad faith or active interference.[10]

Of course, time is an elusive target. Human nature, unexpected circumstances and just plain miscalculation can lead to imminent delays. When delays happen, parties need not immediately gear up for a breach of contract lawsuit. With enough foresight, parties can negotiate extensions (which are incorporated into the existing construction contract) and avoid burdensome disputes.

Payment

Payment provisions can spell out the contractor's compensation, the project's costs and consequences of late payments. For a project's lenders, it is crucial to set specific payment terms to protect financial investment. Payment terms that make it to the construction contract aim to resolve tension between the hiring party's interests and the payee's interests. For example, a contractor would not want to wait until the end of a project for payment because the contractor would have to front all its costs and risk not getting paid upon completion.[11] Conversely, an owner would not want to pay a contractor the entire payment upfront because the contractor would not be incentivized to do the work properly or within a set time.[12] What usually results is a 10% to 20% down payment, followed by progress payments throughout the project, with a certain amount retained until completion.[13] Contractors typically submit written requests for progress payments; but, before they are paid, the architect inspects the work to confirm satisfaction with the specifications.[14]

Owners and developers also must ensure that contractors pay their subcontractors, or risk having to pay to remove a subcontractor's lien from the property.[15] Subcontractors should also avoid "pay if paid" provisions, which are not enforceable in all states but are enforceable in Florida. Under these provisions, subcontractors are not entitled to payment until the general contractor is paid, but only if the contract explicitly states that payment to the subcontractor is "conditioned" or "contingent" on the first payment.[16]

Change Procedures

A construction contract should detail the process of resolving unplanned changes to the scope of work in advance of those changes. Changes are memorialized by change orders, or amendments to the construction contract that modify the scope of work. In theory, the ideal methodology calls for a party proposing the change, the contractor preparing a proposal that quotes a price for the extra work, the parties negotiating that proposal until reaching agreement on the details, and the parties signing the change order before starting the changed work.[17] In practice, project managers in the field are under pressure to keep schedule and often direct contractors to make necessary changes on-the-spot, leaving the details for later.[18] Contractors should beware the risk of non-payment before committing to extra work if the contract requires change orders to be agreed upon and signed by all parties.[19] Some construction contracts allow owners to issue "construction change directives," or CCDs, that allow the owner to unilaterally change the work without agreement from the contractor, with the architect determining appropriate additional compensation and time.[20]

Dispute Resolution

Dispute resolution provisions describe how the parties agree to resolve disputes arising from the project. Of course, parties dispute, but being prepared for them anyway helps avoids having to start at square one in court proceedings how. Parties have several options in these provisions, so they should take time to think about what best suits their circumstances. Among the most basic choices is what state's laws will govern, and relatedly, the venue in which disputes will be litigated. Parties may also choose from a number of alternative dispute resolution options to avoid litigation altogether, including mediation, mandatory negotiation, expert determination and most commonly, arbitration. Arbitration is preferred because parties are bound by the outcome, and though expensive, it normally is not as expensive or time-consuming as litigation. Moreover, parties enjoy the flexibility to agree on an arbitrator with focused construction law experience, as opposed to an assigned judge that may not understand the esoteric issues as well.

If this article has a theme, it is that parties should take care to include exactly what they want, in as much detail as possible, in the construction contract. Parties should not assume that just because a separate pre-project document contains an arbitration provision that arbitration will mandatorily govern project disputes. Sometimes that is the case, like in *Glasswall, LLC v. Monadnock Const., Inc.*,[21] where the parties did not explicitly agree to arbitrate in the construction contract but had incorporated American Arbitration Association rules by reference, which was enough to show the parties' intent to arbitrate. Other times, not so much, like in *JPG Enterprises, Inc. v. Evans*,[22] where an arbitration clause in a warranty agreement did not compel arbitration because the warranty agreement was independent of the relevant home purchase agreement.

Besides alternative dispute resolution, other streamlined judicial processes are used to bring quick, effective resolutions to construction disputes. For example, as a contractor or subcontractor, filing a lien that attaches to the property is a proven extracontractual way to induce owners to address the underlying issue (usually a payment dispute) to remove the lien.

Insurance

In a field like construction with such potential for error and hazard, making certain each party is insured before the project starts is a necessity. Construction contracts dictate how much coverage each party must have, what kind of coverage, and which party supplies the coverage. The most common kinds of insurance required by construction contracts include general liability insurance, workers' compensation insurance and builder's risk insurance.[23] Parties prove their coverages to each other with certificates of insurance before commencing work. General liability insurance protects against property damage and bodily injury claims arising from the work the insured performed, but not injury claims from employees.[24] Those are covered by workers' compensation.[25] Builder's risk insurance protects developers or general contractors from damage or destruction of the completed parts of a project before the property is turned over to the owner.[26] Parties can get professional liability insurance, but more commonly pay an additional premium under their general liability policy to protect against claims of defective work.[27]

The parties and their varying coverages weave together to distribute the project's risk. Owners and developers require general liability policies of their contractors, who in turn require general liability policies of their subcontractors. Contractors commonly are required to indemnify owners for damages arising from their (and their subcontractors') work,[28] and contractors require indemnity from their subcontractors. The duty to defend is a separate protection, and more broadly requires providing a defense for the insured or indemnified party against claims arising from the work.

With respect to workers' compensation, general contractors enjoy a "vertical immunity" from claims by their subcontractors' injured employees if the employees are covered by workers' compensation (and if the general contractor meets other statutory requirements).[29] Similarly, subcontractors enjoy a "horizontal immunity" from claims by other subcontractors' employees covered by workers' compensation (having to also meet statutory requirements).[30]

Conclusion

The provisions described above are by no means an exhaustive list of what can make up a construction contract. There are also a seemingly endless number of issues that can arise from these provisions and others. Nonetheless, the protections they provide are indispensable for parties striving for a harmonious construction project. Developing a detailed construction contract can go a long way in avoiding litigation and allowing the parties to have peace of mind. Even parties with years of years of experience working together should take care to put their expectations down in writing. They may be surprised to learn that they were not in full agreement. Fortunately, putting together a reliable contract does not have to be expensive, with so many forms available from the AIA and others. Preventing all disputes is impossible but there is no excuse for unpreparedness.

1 *See* Stuart M. Saft, 22 West's Legal Forms, Real Estate Transactions, Commercial § 33:2.
2 *Id.*
3 *See* https://aiacontracts.com.
4 *All Year Cooling & Heating, Inc. v. Burkett Properties, Inc.*, 357 So. 3d 131(Fla. 4th DCA 2023).
5 *Id.*
6 *Id.*
7 *Id.* at 132-33
8 *See*, *e.g.*, *Pub. Health Tr. of Dade Cnty. v. Romart Const., Inc.*, 577 So. 2d 636 (Fla. 3d DCA 1991) (holding that the proper assessment for delay damages was contractual liquidated damages, not on-site daily expenses).
9 *See*, *e.g.*, *Triple R Paving, Inc. v. Broward Cnty.*, 774 So. 2d 50 (Fla. 4th DCA 2000).
10 *Id.* at 54.
11 Saft, *supra* note 1, at § 33:3.
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id.*
16 *See DEC Elec., Inc. v. Raphael Const. Corp.*, 538 So. 2d 963, 964 (Fla. 4th DCA 1989).
17 Luke J. Farley, Sr., *Construction 101: The Basics of Change Orders* (2018), https://www.americanbar.org/groups/construction_industry/publications/under_construction/2018/fall/construction-101/.

[18] *Id.*
[19] *See, e.g.*, *JD's Asphalt Eng'g Corp. v. Arch Ins. Co.*, 329 So. 3d 165, 167 (Fla. 3d DCA 2021); *Everett Painting Co. v. Padula & Wadsworth Const., Inc.*, 856 So. 2d 1059, 1062 (Fla. 4th DCA 2003).
[20] Farley, *supra* note 16.
[21] *Glasswall, LLC v. Monadnock Const., Inc.*, 187 So. 3d 248 (Fla. 3d DCA 2016).
[22] *JPG Enterprises, Inc. v. Evans*, 941 So. 2d 1289 (Fla. 4th DCA 2006).
[23] Saft, *supra* note 1, at § 33:5.
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.*
[29] § 440.10, Fla. Stat. (2022).
[30] *Id.*