

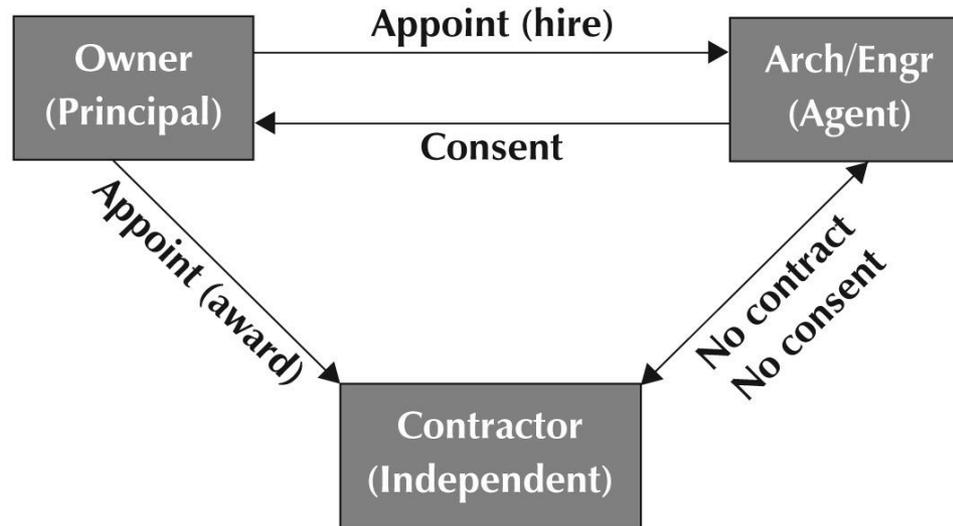


# PROJECT MANAGER DEVELOPMENT PROGRAM

## MODULE **2** CONTRACT ADMINISTRATION

### SESSION 1 INTRODUCTION TO CONSTRUCTION LAW AND PROJECT DELIVERY

# Agency



- Agency represents complicated control but commercial necessity; best choice from among several “bad choices”
- Agents have special duties (fiduciary obligations) not typical in independent contracts

# Agents

- Must act in best interest of principal (hard to measure and enforce)
- Authority should be in writing
- Protected by reasonableness standard and custom/usage doctrines
- Apparent authority allows agent to bind independents (sort of)
- Agency contracts exist for specific time and purpose
- Agency causes many lawsuits in construction

# Planning and Delivery

- Project constraints affect choice of planning and delivery system
- Business judgment, engineering judgment, and legal judgment are all involved in the management triangle, and decisions must be made with an understanding of risk, project goals, and constraints

# Planning and Delivery Systems

- Design-bid-build (Traditional) delivery:
  - Design and construction are separated
  - 100 percent design, then bid, then build sequence
  - Wider range of design possibilities
  - Better quality control (theoretically)
  - Contractor left out of the design process
  - Adversarial relationships develop
  - Cost “designed in” early, hard to fix

# Planning and Delivery Systems (cont'd.)

- Construction Management at Risk:
  - Early contractor input fixes cost parameters and constrains subsequent design decisions
  - Can be two- or three-party contracting
  - Can use multiple subcontractors or self-perform some work

# Planning and Delivery Systems

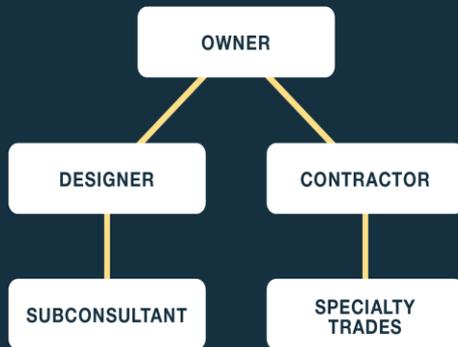
## (cont'd.)

- Design-Build:
  - Single party contracts for both design and construction
  - Lower cost and schedule growth
  - Owner gives up some control

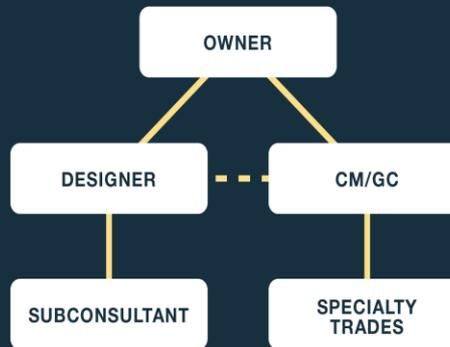
# Planning and Delivery Systems (cont'd.)



## Traditional Design-Bid-Build



## Construction Manager @ Risk



## Design-Build Project Delivery



CONTRACT



COMMUNICATION

# Planning and Delivery Systems (cont'd.)

## PROs

## DESIGN-BUILD

## CONs

*Client hires a contractor-led design and build team*

- ✓ Contractor input during design to suggest cost saving options
- ✓ Overall faster project delivery
- ✓ Early identification of costs / price guarantees
- ✓ Single contract for design and build delivery helps eliminate design-related change orders (reduces cost and client's risk)

- ✗ Single contract could result in loss of checks & balances
- ✗ Client has less time to react to make important design decisions to take advantage of speed of process

## CONSTRUCTION MANAGER AT RISK (CMR)

*Client hires a contractor for preconstruction and construction services*

- ✓ Contractor input during design
- ✓ Transparency of bid process & selection of subcontractors
- ✓ Scope clearly defined during design
- ✓ Cost and schedule guaranteed with ability to expedite

- ✗ Price assumptions on the current design potentially leads to disputes and change orders
- ✗ Separate design and construction contracts results in client managing more entities and leads to increased cost
- ✗ Requires multiple bid packages and additional time for design team

## DESIGN-BID-BUILD

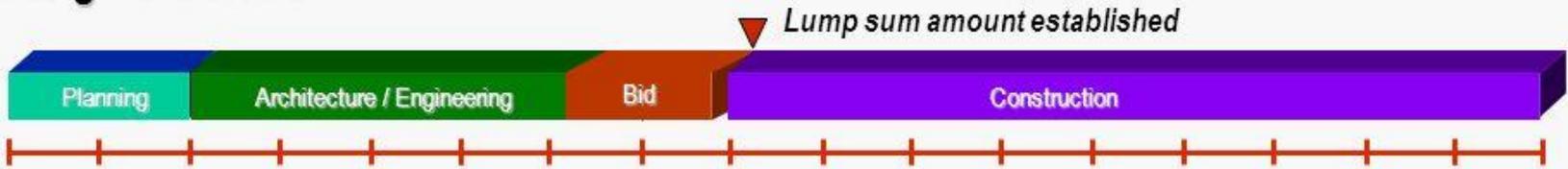
*Client provides complete drawings and specifications to receive a lump sum bid from contractor*

- ✓ Design complete prior to construction
- ✓ Client has greater control over the process since the design team and general contractor reports directly to client
- ✓ Potentially result in hyper competitive bids

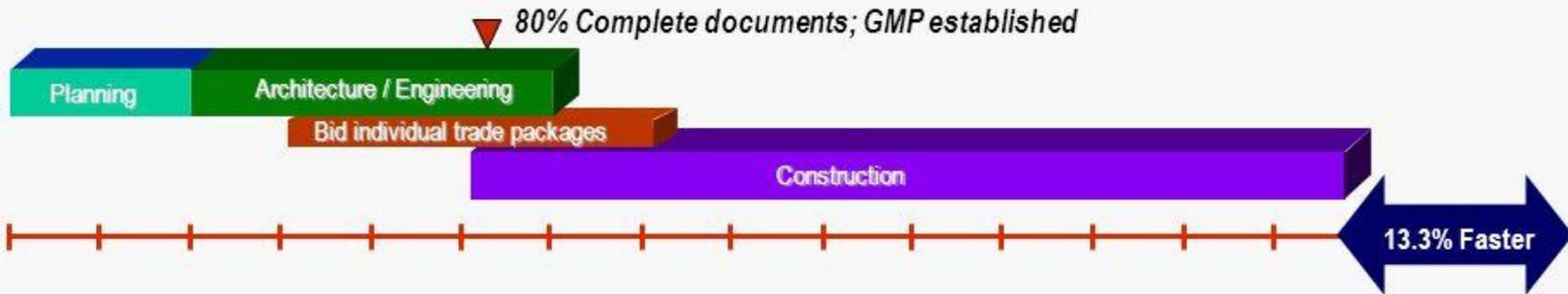
- ✗ No open book accounting
- ✗ No drawing review by contractor prior to bid for scope gaps
- ✗ Does not allow for fast track projects (longer construction schedule)
- ✗ Client has greater exposure to change orders and claims for design and/or constructability issues
- ✗ Contractor selects subcontractors with no client input

# Planning and Delivery Systems

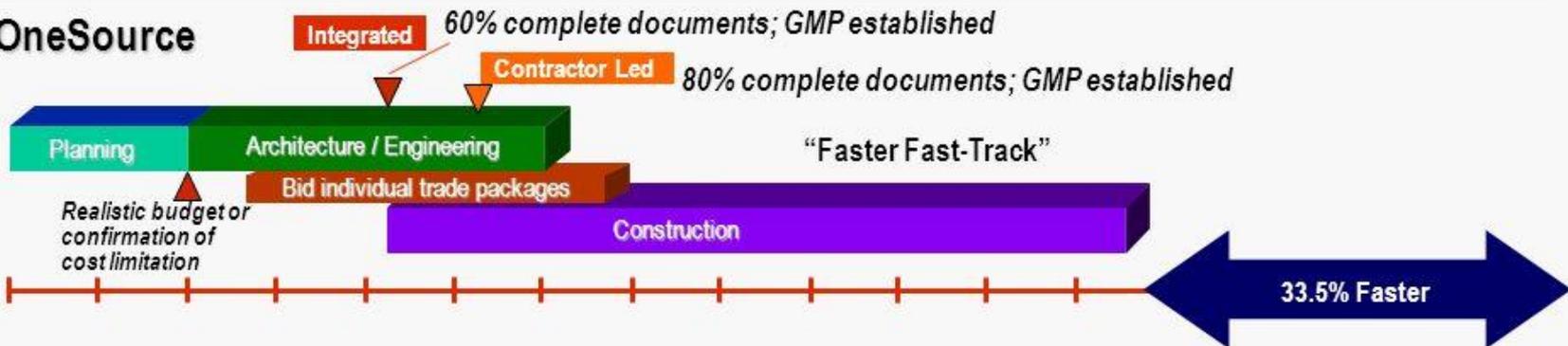
## Design-Bid-Build



## CM at Risk

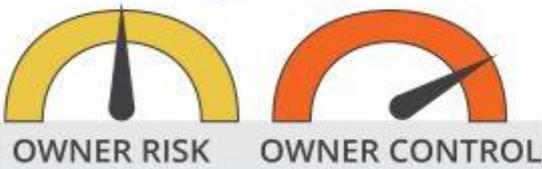


## OneSource

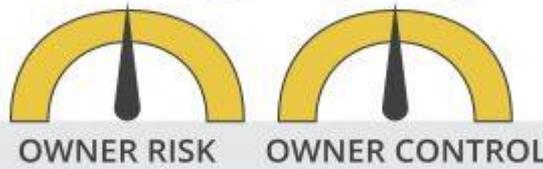


# Planning and Delivery Systems (cont'd.)

## COMPETITIVE SEALED PROPOSAL



## CONSTRUCTION MANAGER @ RISK



## DESIGN-BUILD



# Planning and Delivery Systems

## (cont'd.)

- Hybrid forms:
  - Design-Assist
  - Design-Build-Operate
  - Design-Build-Operate-Transfer
  - Contractor-Financed
  - Construction Manager as Agent



# PROJECT MANAGER DEVELOPMENT PROGRAM

MODULE **2** CONTRACT  
ADMINISTRATION

SESSION 2  
CONTRACT BASICS

# Contract Basics

- Each contract carries a promise and performance expectation
- Legal enforcement promotes economic efficiency (lowers risk)
- Without a contract, no recourse to enforcement
- Must have capacity to contract (fiscal agency, accurate information, etc.)
- In USA, contracts are usually enforced under assumption of autonomy and equality of power between parties, but can have “adhesion contracts”
- Contracts can be expressed (expectations detailed) or implied (expectations implied)
- Use standard forms, but add riders or addenda with specific (expressed) terms

# Contract Basics (cont'd.)

- Different commercial exchanges have different contract guidelines:
  - Land sale
  - Sale of goods (UCC)
  - Loans and mortgages
  - Leases
  - Money handling (investment accounts)
  - Services (design, construction, etc.)
  - Insurance

# Contract Formation

- Contracts are formed when there is mutual agreement on performance and promises, or **offer and acceptance**
- Offer and acceptance can be via correspondence or phone or conversation, but there must be **reasonable certainty** of terms for contract to be enforceable; best to have documentation
- When documentation is not possible and uncertainty exists (such as early in a project), parties can have pre-contracting agreements such as good-faith bargaining (agree to agree later), memorandum of understanding, or letters of intent

# Contracts

- Some types of contracts must be in writing:
  - Land sale
  - Sale of goods over \$500
  - Loans and mortgages
  - Leases
  - Money handling (investment, bank accounts, lines of credit, etc.)
  - Service agreements (design, construction, consultants, etc.)
  - Insurance and bonding

# Contract Formation

- Problems arise when:
  - There is fraud or misrepresentation by one of the parties
  - One party agrees under duress
  - There are mistakes in the offer (bid mistakes)
  - There are unconscionable or exculpatory terms
  - There are formation defects in the contracting process
- Consideration—not all promises are enforced; must contain consideration to fall under legal review:
  - Bargain—must be value for both sides
  - Reliance—one party must act on the assumption that the other party will comply with terms (borrow money to begin construction)

# Project Relationships

- Employment Contracts:
  - Typically at-will
  - Employer assumes liabilities
  - Employee has limited power (fiscal agency)
- Subcontracts:
  - Written agreement for performance of a segment of the work
  - NOT considered at-will (cannot fire subcontractor's workers)
  - Can be furnish only; furnish and install; install only; or design, furnish, and install subcontract

# Uniform Commercial Code

- Stipulates the rights and responsibilities for buyers and sellers of goods
- Doesn't apply to service contracts
- Codifies shipping, title, insurance, transit risk
- It is important in material purchase contracts to clearly state when ownership and risk transfer (FOB jobsite or factory)

# Bidding

- Acceptance must reflect terms of the offer
- If changes are made to a bid proposal, it becomes a counter-offer
- Consideration is value given to a party in return for performance
- Whenever scope changes, consideration changes

# Bidding Mistakes

- Unilateral: one-party mistake; won't alter the contract unless it's a patent (obvious) error
- Mutual: both parties make a mistake; agreement is voidable by either party
- Transcription error: oral agreement not accurately reflected in written version; can be reformed, but there is a high burden of proof

# Bidding Mistakes (cont'd.)

- Federal: rescission or reformation of the bid is allowed
- State: rescission only (if the error is significant and noticed before start of construction)
- Subcontract governed by states only: majority make bids irrevocable for a reasonable time if used in the contractor's bid (promissory estoppel)

# Bidding Mistakes (cont'd.)

- Promissory estoppel allows for bid shopping, which is technically legal but unethical
- A few jurisdictions allow subcontract bids to be revoked prior to acceptance
- In California, a bid is revocable unless the contractor makes a conditional acceptance
- Telephone bids are valid offers except for material purchases over \$500



# PROJECT MANAGER DEVELOPMENT PROGRAM

MODULE **2** CONTRACT  
ADMINISTRATION

SESSION 3  
NEGOTIATING FAIR CONTRACTS

# Issues in the Industry

- Avoiding lawsuits:
  - Be honest, admit mistakes
  - Add value for those paying you
  - Pay those who add value for you
  - Cooperate to fix mistakes (don't punish)
  - Don't get fixated on small issues
  - Understand and listen well
  - Learn that “different” is not wrong or bad
  - Avoid “standing on principle”—pick your battles

# Effective Negotiating

- Have the decision makers participate in the negotiation
- Don't go back on your promises; once you have agreed to something, stand by it
- Keep your emotions out of the negotiation.
- Be professional and respectful
- Use appropriate language and civil behavior

# Effective Negotiating (cont'd.)

- Do not take comments personally
- Do not get defensive
- Do not hold a grudge
- Take a “cooling off” period if needed
- Actively listen to the concerns and issues of the other party
- Offer solutions that meet at least some of the other party’s needs

# Effective Negotiating (cont'd.)

- Do your homework; understand the issues
- Keep the overall agreement in mind when working out details
- Keep a balanced, “give-and-take” approach to the overall negotiations
- Make certain details of the agreement are clearly understood before ending the negotiations

# Effective Negotiating (cont'd.)

- When negotiating with an owner or designer for change orders, you must be an advocate for the subcontractors
- Use partnering principles to promote cooperation in negotiation
- Reputation and integrity will be critical to future negotiations

# Negotiating Change Orders

- Identify source or nature of change in scope
- Estimate cost impact
- Estimate schedule impact
- Present reasonable logic to owner in negotiation

# Negotiating Change Orders

## (cont'd.)

- “No cost” changes should still be documented in case they become numerous
- Stay current in submitting, negotiating, and executing change orders
- Contractor is **not** responsible for coordinating plans and specifications in traditional design-bid-build (Spearin Doctrine)

# Effective Negotiations

- Know the contract language on notification period, evidence, and documentation
- Understand the approval process (who needs to approve the changes, who will sign, etc.)
- Change orders are incorporated into the original contract and will affect schedule of values

# Effective Negotiations (cont'd.)

- Costs resulting from extra work required for a change cannot be billed to the owner until the change order has been executed
- Failure to promptly negotiate and execute change orders has a negative effect on project cash flow
- Keep the number of people involved in the negotiation to the smallest possible number to get the deal done
- Spearin Doctrine: the designer is responsible for providing complete and coordinated construction documents



# PROJECT MANAGER DEVELOPMENT PROGRAM

MODULE **2** CONTRACT  
ADMINISTRATION

SESSION 4  
CONTRACT DOCUMENTS

# Contract Documents

- Because of large number of contracts in construction, industry relies on standard forms
  - ConsensusDOCS:
    - 200 series- General Contracting
    - 300 series- Project Collaboration
    - 400 series- Design-Build
    - 500 series- Construction Management
    - 700 series- Subcontracting
    - 800 series- Program Management

# Contract Documents

- Other industry groups have developed standard forms:
  - Engineers Joint Contract Documents Committee (EJCDC)
  - Industry groups use different contract language on important issues such as indemnity, liability, and other risk factors, so read carefully.

# Contract Documents

- **ConsensusDOCS:**
  - Introduced September 2007
  - Developed in partnership with over 20 organizations representing **D**esigners, **O**wners, **C**ontractors **S**ubcontractors and **S**ureties (DOCS)
  - Collaborative effort on contract language in the best interest of the project (not any one party)
  - More than 70 different contract types

# Contract Documents

- After bidding or negotiating to establish price and scope, a contract must be executed—called the basic agreement
- Basic agreement is only one of the documents used to establish “the contract”
- Contracts often bind parties to “industry standards” rather than spell out express performance

# Contract Documents (cont'd.)

- Incorporation by reference is used to bring written documents into the contract without physically attaching them to the contract
- “In accordance with” plans, specs, etc., with date and page numbers noted, brings the construction documents into the contract by reference
- Must avoid contrary or ambiguous documentation—can “over specify” a contract
- The more places a requirement is mentioned, the more chances there are for contradiction
- Use of informational reference helps (ASTM, UL)

# Contract Documents (cont'd.)

- Contract documents:
  - Drawings (C,L,A,S,M,P,FPS,E,ID)
  - Specifications
    - New Master format has 40 sections—used increasingly
    - Old CSI format
      - (bid instructions {section 0})
      - general conditions
      - supplemental conditions {section 1}
      - technical sections {section 2-16}}
  - Soils reports
  - Other reports (environmental, asbestos, etc.)
  - Modification process needs to be articulated

# Contract Documents (cont'd.)

- Performance vs. product specs will determine contractual liability for design
- Performance specifications make builder or design-builder responsible for design
- Can have “agree to agree” clauses or “agree to disagree” clauses; can use implied terms
- Implied terms are defined by the courts, becoming more prevalent with use of standard contract forms, which indicate a lack of specific discussion

# Contract Documents (cont'd.)

- Custom and usage terms: when in disagreement, the custom and usage of the industry set contract terms (example: air- entrained concrete)
- Important to “know the custom” before you agree to it
- Building codes, municipal laws, permitting procedures
- Good faith and fair dealing: intended to prevent “willful frustration” and set up a less adversarial project team
- Unconscionability: circumstances underlying the negotiation can influence court judgments

# Contract Documents (cont'd.)

- Electronic creation, distribution, and archiving of documents are becoming common
- Need to control access (don't want subcontractors to be able to modify architectural CAD plans)
- Also need to have certification and verification (electronic signatures)

# Contract Documents (cont'd.)

- Electronic archiving and retrieval of contract documents:
  - Aids in retrieving specific documents or documents related to a specific topic through the use of searchable archives
  - Makes archiving more efficient and reduces risk

# Contract Changes

- Types of changes:
  - Cardinal change: drastic change, either single direction or accumulated change in scope
  - Constructive change: proceed with work even though there is disagreement over price or justification (usually document conflicts)
  - Directed change: owner asks for additions/revisions to work
  - Deduct change order: owner may not deduct to give the work to others without basis, and usually cannot reduce POH (except federal work)

# Contract Changes (cont'd.)

- Changes in scope require directive change orders
- Changes in time require delay or acceleration claims
- Most claims are handled in change orders
- Change orders must be in writing and confirmed
- Contractor is entitled to profit and overhead

# Contract Changes (cont'd.)

- Field changes are used when there is no time for prior approval
- Explain and document (notification clause)
- Architect issues change directive, then contractor submits claim (may require court or arbitrator hearings)
- Constructive change for extra work caused by defective plans and specs or owner misrepresentation

# Delays

- Inexcusable: contractor pays costs
- Excusable: each party absorbs costs:
  - Contract delays are usually spelled out in contract
  - Law delays are granted by court or statute
- Compensatory: owner pays contractor for additional costs (e.g., summer work moved to winter work)



# PROJECT MANAGER DEVELOPMENT PROGRAM

MODULE **2** CONTRACT  
ADMINISTRATION

SESSION 5  
PAYMENT TERMS

# Payment

- Subcontractor payment:
  - Usually a progress payment based on percentage complete, similar to contractor and owner
  - Must verify that percentage of work billed for is consistent with the percentage of work completed in the field
  - Try to have subcontractor bills come in just before you need to prepare pay application to the owner

# Payment (cont'd.)

- Assignment of payments: payments used as collateral for loans may be assigned to the lender
- Payments can be sent by the contractor directly to the lender (the assignee), but you should always have a written right of transfer from the subcontractor
- Direct lender payment: not usually a good idea to have lender pay directly to contractor on behalf of the subcontractor because it confuses the role of contracting parties

# Payment (cont'd.)

- Joint checks: A check for payment is issued to two firms, requiring co-endorsement to be cashed or deposited; used when a subcontractor has very bad credit or is in reorganization/ bankruptcy but needs material
- Surety request to cease payments can be grounds for breach of contract since the owner has no contract with the surety; recent legal cases have suggested that surety requests must be “considered,” but not necessarily honored

# Payment (cont'd.)

- Doctrine of conditions: in any contract, one of the conditions that must be established is “who goes first,” the payer or performer
- Different industries have different conditions, but most require the performer to go first (common law interpretation); the contractor almost always has to perform prior to payment
- Some conditions require payment first (athletic tickets, artistic commissions)

# Payment (cont'd.)

- A literal application of the doctrine of conditions would require a contractor to perform all of the work prior to receiving payment
- Payment is typically made as progress continues because of the extreme financial hardship a literal interpretation would impose
- Progress payment schedule is a compromise between strict doctrine of conditions and financial reasonableness

# Payment (cont'd.)

- Progress payments are based on a pre-determined schedule of values
- Contractor's rep (project manager) submits an application for payment at a contractually stipulated time for all work incorporated into the project, plus material stored on or off-site (off-site is trickier)
- Owner or rep (architect/engineer) inspects the jobsite to warrant that the work billed for is in place

# Payment (cont'd.)

- Schedule of values aggregates all of the tasks from the estimate into broad categories of work
- Schedule of values may have as few as 12 categories and as many 75, depending on the owner and the type of form used
- Costs of all the tasks from the estimate and subcontractor bids must be allocated to different sections

# Schedule of Values

- **Example:**

– Site work.....	\$29,972
– Excavation.....	\$63,454
– Concrete.....	\$51,234
– Masonry.....	\$26,768
– Metals.....	\$97,846
– Carpentry.....	\$12,498
– Roofing/insulation.....	\$87,498
– Windows, doors, hardware.....	\$17,895
– Interior finishes.....	\$73,971
– Specialties.....	\$10,786
– Fire protection.....	\$39,783
– HVAC/plumbing.....	\$92,789
– Electrical.....	\$60,299

# Schedule of Values (cont'd.)

- Total of all categories is \$664,793
- Only 13 categories are listed
- Estimate may have several hundred cost items
- In the example given, general conditions, overhead, and profit are allocated across work categories
- In some schedules, there are separate entries for general conditions, overhead, and profit

# Schedule of Values (cont'd.)

- Owner or rep (A/E or loan rep) then certifies that the dollar amounts are in compliance with schedule of values contained in the contract
- Time of payment is usually ten to 30 days, depending on contract language; long pay periods can become financially burdensome
- Legally (common law), title to work-in-place passes to owner as soon as it is incorporated, but frequently contract clauses pass title to owner as soon as payment is made
- Insurance covers losses as stipulated in the contract, regardless of who has title

# Non-Payment

- Remedy for non-payment: some lateness is reasonable and allowable, but after some lapse of time, non-payment becomes a terminal breach of contract
- Contractor is owed interest for non-payment from the date payment was due
- Contractor may suspend work, but contract termination for non-payment is much more complicated and lengthy

# Payment as Waiver

- Payment as waiver: progress payments from the owner are not an acceptance of the work or a waiver of defects
- Final payment and retainage release are exceptions; they are waivers of defects
- Sometimes tort settlements act as waiver of future claims—if you take the settlement, you cannot file future claims for additional loss
- Construction contracts are not considered divisible, even though a schedule of values could lead to that interpretation

# Retainage

- Payment as preference: if the contractor does not have the cash flow to pay all of the subcontractors, it cannot show preference to one over another
- Retainage: owner holds back a designated percentage of all payments (usually 10 percent until 50 percent completion, then 5 percent until final completion) to secure satisfactory completion of the work
- In some states, retainage is statutory

# Substantial Completion

- Substantial completion: habitable and usable building; usually occurs upon issuance of occupancy permit from building inspector, along with final inspection and punch list creation
- Substantial completion is important for insurance and liability reasons
- Completion and final payment: usually when punch list is done and operations & maintenance documents have been turned over to the owner



# PROJECT MANAGER DEVELOPMENT PROGRAM

MODULE **2** CONTRACT  
ADMINISTRATION

SESSION 6  
LEGAL ISSUES

# Indemnification

- Killer clauses: contract language that relieves one or more parties from any liability regardless of their fault or contribution to the loss
- Broad form indemnity (making one party responsible for all loss regardless of who is responsible) is viewed unfavorably by the courts
- As a rule, contracts cannot indemnify someone from their own negligence
- No damage for delay, bid waiver, code compliance, and differing site conditions are some of the major issues to look for in killer clauses

# Contract Time

- Commencement is usually denoted by a Notice to Proceed order from owner (a letter along with necessary permits)
- There can also be contractor notification clause in the contract stipulating that the contractor send written notice that work has begun

# Contract Time (cont'd.)

- Constructive acceleration claim is generated by owner's refusal to grant a time extension for changes in scope or condition (additional work)
- Contractor must then spend more money to stay on original schedule, justifying the claim for recovery
- A request for early completion is handled like a standard (contract) change order
- Sometimes contractors can be prevented from early finish because of hardship on owner (lease may still be in force on current building)

# Contract Time (cont'd.)

- Project schedule is often required under contract terms and can have legal standing in the case of a litigated claim
- Advent of CPM schedules, which establish relationships in activities, have made claims more complex but also probably made relief more realistic

# Contract Time (cont'd.)

- Many contracts have “liquidated damages” clauses, paying owner a predetermined amount of money for each day the project is delayed
- Liquidated damages must be based on actual cost to the owner (e.g., lost rent, temporary storage, etc.); difficult to calculate prior to commencement—must make assumptions
- The main issue is fairness and process used, not precise calculation; cannot be intended as punishment (delay is not a tort)
- If owner takes the liquidated damages, cannot then file a claim; can only have one or the other

# Cause of delay

- Causation can be by:
  - Contractor (owner can file claim or liquidated damages allowed)
  - Owner (contractor can file claim for delay or acceleration)
  - No cause (e.g., accidental fire): no claims
  - Mutual cause: no claims
  - *Force majeure* clauses list specific events for which the contractor will be granted an extension

# Mechanic's Liens

- Rules for mechanic's liens vary by state
- Mechanic's liens protect subcontractors, vendors, and suppliers from non-payment
- Any person or organization who has added value to the project but has not been paid can file a mechanic's lien, essentially preventing title transfer on the project until payment is received
- Most owners require contractors to submit lien waivers from each subcontractor, vendor, or supplier with their application for payment

# Dispute Resolution

- Main aspects of arbitration hearing:
  - Production of evidence: subpoena
  - Documentary evidence
  - Questioning of witnesses
  - Site inspection
  - Reopening for additional or new evidence (if any)
  - Ex parte communication: can't communicate in secret with the arbitrator

# Dispute Resolution (cont'd.)

- Award is given in a short, reasoned statement without a lot of explanation
- Enforcement of the award is turned over to the courts as a civil matter
- Insurers and sureties are often exposed in arbitration without defense or participation; this is problematic and will probably have to be handled with statutory process

# Dispute Resolution (cont'd.)

- Arbitration is probably the most common and most effective dispute resolution technique, but there are others:
  - Mediation: make suggestions and facilitate discussion
  - Mediated arbitration: mediate for some designated time, but then mediator gets to decide
  - Mini-trial
  - Review boards: expert panel, more common in large highway/heavy jobs



# PROJECT MANAGER DEVELOPMENT PROGRAM

## MODULE **2** CONTRACT ADMINISTRATION

### SESSION 7 CONTRACTING WITH OTHERS FOR REQUIRED WORK

# Subcontracting

- Owner doesn't "recognize" subcontractors
- They are representatives of the contractor
- General contractor usually uses flow-down clauses to align subcontract with prime contract
- Contractor must be confident it can perform:
  - Reputation
  - Financial strength
  - Labor force
  - Job history
  - Strength and skill of PM
  - Past work with team
  - Estimating ability

# Subcontracts

- Increasing the number of subcontractors on the job reduces financial risk to GC but increases communication complexity, coordination time, and cash flow issues for the project team
- Decision to subcontract versus self-perform is a risk/return optimization problem
- Self-performed work has potential for greater reward, but carries more risk
- Self-perform is less risky when you have long-term trades people and well-understood markets

# Subcontracts (cont'd.)

- Subcontracting passes risk on to subcontractor in return for known cost
- Subcontracting can shorten schedule and improve quality/efficiency if subcontractor has access to superior technology, equipment, resources, or knowledge
- Subcontracting can also reduce schedule flexibility because of contractual constraints and inability of general contractor to add labor

# Subcontracts (cont'd.)

- Subcontracts can be negotiated or competitively bid—usually determined in part by the owner
- Subcontractors can be asked to do value engineering, but must be careful about bid comparison and bid shopping
- Keep subcontractors “in the loop”
- If you’re not sure whether subs need a document or piece of information, err on the side on inclusion and send it to them

# Procurement

- You should put together a procurement strategy to meet project goals
- Identify source, lead time, “bundling” of services (e.g., studs, drywall, taping, painting as one package) and method of purchase
- Expedite long-lead-time items and critical path subcontracts

# Integrated Procurement

- Use of integrated suppliers is becoming more common in construction
- Use of 3-D CAD and building information modeling (BIM) makes integrated procurement possible
- Bid plans, shop drawings, field assembly, and coordination with other trades can happen electronically in an integrated manner



# PROJECT MANAGER DEVELOPMENT PROGRAM

## MODULE **2** CONTRACT ADMINISTRATION

### SESSION 8 CONTRACT TERMINATION AND MODULE SUMMARY

# Breach of Contract

- Termination of contract is rare; it requires a material breach (not partial breach)
- Partial breach is insignificant failure to perform, such as painting a room the wrong color
- Technically, you did not fulfill the contract requirements, but not in a way that relieves the other party of its obligations
- Material breach is invoked if one party tries to terminate the contract based on a partial breach by the other party
- Only material breach of contract results in contract termination and award of damages by the court

# Breach of Contract (cont'd.)

- Determination of “material breach” is subjective
- Damages are the sum of money to compensate for economic loss resulting from the breach of contract
- Termination for breach is always a litigated matter

# Breach of Contract

Court will ask the following questions:

- Is there language allowing the contract be rescinded or terminated by one of the parties?
- Is there a differing condition resulting in impossibility? Can the work no longer be performed?
- Has there been a material breach of contract, such as non-payment, that effectively terminated the contract?

# Termination

- Many contracts have language allowing the owner to “terminate for convenience”:
  - Owner must pay costs to point of notification plus overhead
  - Owner typically can’t give work to others after terminating
  - Must send notice of termination as spelled out in the contract, then material and equipment ownership transfer occurs, final payment claims are submitted, and termination dispute arguments (if any) are entered

# Termination (cont'd.)

- Some contracts contain language allowing “termination for mutual convenience”:
  - Neither party is responsible for the inability to complete the contract
  - Mutual convenience is “uncontracting,” so same requirements for contracting must be present (mutual assent, full disclosure, etc.)
  - Mutual termination usually requires a dramatic triggering effect (e.g., 9/11 attacks or Katrina)

# Bankruptcy

- Chapter 7: debt liquidation
  - Unsecured debts discharged (creditor: no security)
  - Secured debts: underlying asset can be sold to make good on the debt (or a portion thereof)
  - Usually means the company is going out of business
  - Exempt assets are listed in law
  - Unlikely that work will continue or much of the debt will be recovered

# Bankruptcy (cont'd.)

- **Chapter 11: business reorganization**
  - Creates breathing room to allow company to get back on its feet
  - Debtor continues to operate as debtor-in-possession
  - Can be forced into Chapter 7 if company falls behind reorganization plan for credit
  - Work can continue, and there is likelihood subcontract will be completed

# Bankruptcy (cont'd.)

- Executory contracts: parties continue to have duties and obligations to each other in spite of bankruptcy; construction contracts are usually considered executory
- Construction bankruptcy actions:
  - Forced return of payment if fraudulent or preferential
  - Liens may be filed but not acted on
  - Contract enforcement shifts to trustee of creditor group (no longer dealing with owner or subcontractor)
  - Retainage becomes an asset of bankruptcy; contractor must “stand in line” with other creditors

# Involuntary Bankruptcy

- A person or business is forced to declare Chapter 7 or 11 bankruptcy
- Involuntary declaration is an attempt to control debtor actions by creditors
- It is usually used when assets are being moved between subsidiary companies
- Forcing a subcontractor into bankruptcy would normally be the last choice a general contractor would make

# Impacts of Bankruptcy

- Bankruptcy can lead to termination
- Subcontractors going bankrupt in the middle of a project causes many problems
- Prevention is the best practice; make sure you allow only financially strong, well-managed subcontractors onto the qualified bidders list
- Verify owner's ability to pay before signing the contract

# Module 2 Summary

- This module included information on:
  - The basic requirements for contract formation
  - Specific examples of contract language that should be reviewed carefully
  - The ways contract responsibilities vary based on project delivery method
  - The process for amending the contract and procuring the work
  - Terms and conditions for owner and subcontractor billing

# Module 2 Summary (cont'd.)

- This module included information on:
  - options for resolving contract disputes, including legal proceedings
  - best practices for negotiating good contracts and subcontracts
  - the conditions under which a contract or subcontract can be terminated
  - the process for making final adjustments to the contract, including delay claims
  - the ways the courts handle breach of contract and damage awards