MANAGING CONSTRUCTION RISK

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INTRODUCTION

This program is designed to provide you with general understanding of construction risk and the various methods of minimizing the risk. Most construction risk cannot be eliminated. Adverse weather conditions will occur; labor or material shortages are a part of the process; inadequate or incompetent project management exists; designs are sometimes inadequate or inaccurate. On the other hand, virtually all construction risk can be allocated among the parties in the way they see fit. It should go without saying, however, that a party accepting risk expects to be compensated for that allocation. In short then, this program is designed to help you understand how construction risk is allocated.

The approach we will take is a hierarchical one. We start with contract delivery systems because this is where the broadest allocation occurs. In the broadest sense the risks accepted by a construction manager at risk are inherently different than a traditional design-bid-build general contractor. The second broadest determinant of risk allocation is the pricing model. A lump sum contract allocates price risk differently than a cost plus contract. Finally, we look closely at the specific contractual provisions that attempt to allocate construction risk among the parties.

One of the greatest financial risks in a construction project is that the project cannot be completed as designed or intended for the price established or within the time established. Almost invariably, this will result in claims. We will discuss the numerous contract provisions that affect a claim but because claims for additional time and/or loss

of productivity typically result in the largest – and certainly the most complex – claims, we will address these claims in detail. The purpose, however, is not to exhaust the subject or teach you specifically how to prosecute or defend such a claim, each is too fact specific for that treatment. Instead, we believe that a thorough understanding of these claims is required in order to properly evaluate the contract terms and minimize, or at least properly allocate, the risk.

WHAT IS CONSTRUCTION RISK?

The dictionary has many definitions of risk. I quote several to set up the context of our presentation: "the possibility that something unpleasant or unwelcome will happen;" or "a possibility of harm or damage against which something is insured;" or "the possibility of financial loss." All of these definitions fit our discussion.

Perhaps nothing describes what we are trying to accomplish in this paper and this seminar better than a quote from the immortal Lee Trevino when he was asked whether he was nervous when he stood over a putt worth tens or hundreds of thousands of dollars. Dismissing this context as real pressure, Trevino said "You don't know what pressure is until you have played for $5 a hole with only $2 in your pocket." In the context of a construction project, what we should learn from Mr. Trevino's statement is that real risk is something you are not prepared to handle.

This paper is intended to prepare you to handle most risks you face in the construction process. The first step, of course, is to accept that every construction project has risks that cannot be eliminated. For instance, no one can eliminate the possibility that it will rain at the project site all day, every day during planned sitework operations.

You must also understand that, with few exceptions, the parties are free to allocate that risk among the parties any way they prefer. In a typical construction contract, unusual and unanticipated weather delays are considered excusable, non-compensable delays. But, if you could find a contractor willing to accept the risk, the contract could make weather unexcused and the entire risk of unusual weather would be on the contractor. This is an extreme and unlikely allocation of risk in order to illustrate the point.

Finally, you must understand that for each risk, the party that accepts that risk expects to be compensated for accepting that risk. In our illustration, the contractor that accepts the risk of weather should expect the owner to allow a longer schedule to complete the project or higher compensation for accepting the risk, or both.

For our purposes, we will define construction risk as any event or circumstance that is uncertain at the execution of the contract that will have a financial impact on one or more of the parties.

Generally speaking, the best risk allocation schemes places the financial risk on the party most capable of controlling the risk. For instance, the risk of design errors or inadequacies should be placed on the designer, the risk of construction errors should be placed on the contractor etc. Of course, there are some risks that are not within the control of any party and those risks can be allocated in any way acceptable to both parties to the contract. Our purpose with respect to those types of risks is to identify them, describe the traditional approach to their allocation and provide an understanding of their treatment by the most popular standard form contracts.

CONTRACT DELIVERY SYSTEMS

As we have described it then, risk management includes identifying and eliminating risks where possible and minimizing and allocating risk among the parties where it is not possible to eliminate it. The bulk of our discussion is related to risk allocation and through that discussion we will also be identifying common risks. We have chosen to begin this discussion with a description of traditional and less traditional forms of contract delivery systems not only because it is the first of many risk allocation decisions that must be made but also because in many ways the choice of the right delivery system may be the most effective way to minimize risk.

Some risks, such as weather delays or unusual and unanticipated rock formations in the soil, cannot be eliminated or minimized. We believe that one of the primary risks to the successful completion of a construction project is the risk that the owner, the designer, and the contractor are not using the same playbook; in a word, communication or a lack of real communication. This could lead to subtle problems or to a complete collapse of the working relationship of the parties. The choice of a delivery system that involves the contractor in pre-construction or perhaps even pre-design activities may have a significant impact on this risk. On the otherhand, the choice of a delivery system that involves the contractor in these activities will be more expensive.

I. DESIGN-BID-BUILD

Design-build-bid projects are the traditional paradigm where the owner selects a designer and then awards a contract to a general contractor based upon bids priced in reliance upon the design documents. The owner awards the general contract to the lowest

responsible, responsive bidder who then either self-performs the work, subcontracts the work, or some combination thereof.

The relative risk to each of the parties in this traditional contracting approach will depend in large measure on a number of negotiable contract terms and the pricing mechanism chosen. For instance, the risks of cost overruns are allocated differently in a cost plus contract as compared to a lump sum contract. The most important of the risk allocation contract terms will be addressed later in this paper.

The advantage of this delivery system is that the owner maintains control over the design process and has the opportunity to seek competitive bids based upon the design. Theoretically, this process should result in a favorable price as contractors compete for the work based primarily on price.

A disadvantage of the DBB delivery system is that neither the owner nor the designer has had the benefit of input from the builder during the early stages of the project. The advantage of early builder involvement is early adoption of a constructable project, more accurate construction schedule, a builder who understands the owner and designer's plans, and more accurate cost estimates. Moreover, there is at least an opportunity for the contractor to provide value engineering.

Another disadvantage is related to the relationship of the parties. Although to a certain extent the architect and the contractor serve to guard against abuse by the other, the owner loses the ability to rely upon a single responsible party when problems arise. Most construction issues involve a mix of design and build problems and any problem is likely to lead to finger pointing and possibly a detrimentally adversarial relationship between the contractor and the designer.

II. DESIGN-BUILD

Design-build contracts alleviate many of the concerns related to DBB contracts. Under this system, the owner engages a single development, design, or construction firm with responsibility for both design and construction. When problems arise, the owner has a single source of responsibility. In addition, the designer and builder are more likely to work well together since they are members of the same firm. By far, the greatest advantage of the design-build delivery system is the possibility of dramatically shortening the length of the project.

The design-build system also has its negatives. Primarily, there is a concern that the owner will lose some control over the design. In addition, since the designer and the builder are working together there is no independent check on them. The owner cannot count on the designer checking the contractor or vice versa.

III. CONSTRUCTION MANAGEMENT

A. Construction Manager At Risk ("CMAR")

The role of the CMAR varies from one project to another. Generally speaking, a CMAR is a general contractor who is also involved with some pre-construction services. As such the CMAR usually works with the owner and the designer to develop cost estimates, schedules, value engineering, and constructability reviews early in the process. In addition, the CMAR will usually be involved in purchasing long lead time items. Where the construction manager is expected to be "at risk" the pre-construction services will also include developing the lump sum price or the guaranteed maximum price. The CMAR will almost certainly be involved in preparing bid packages and evaluating bid proposals.

In a private construction contract, the CMAR may or may not self-perform some of the work. Under North Carolina law, the CMAR on a public project may not self-perform unless the bidding produces no responsible, responsive bidder, or the low responsible bidder refuses to sign the contract or defaults and the public entity approves the CMAR's self-performance. *N.C. Gen. Stat.* § 143-128.1(c).

Although the preconstruction phase does not involve the same level of construction risk as the construction phase, there is risk. In addition, the early involvement of the CMAR with design, scheduling, and cost estimates will change the profile of potential claims and disputes.

One of the risks that should be carefully evaluated relates to the scope of the preconstruction services. Both parties should have a clear understanding of the services required and the timing and compensation expected for them. Pre-design and pre-construction services can vary from contract to contract but should be clearly stated.

The CMAR contract should clearly state that the CMAR is not accepting any responsibility for design services. Although the CMAR usually will be consulting on the design and performing such services as constructability reviews and value engineering, it should be careful to defer all design decisions to the design professional and the contract should clearly state that the CMAR is not assuming design liability.

Although the CMAR usually provides one or more pre-bid estimates, it is not providing the owner with any pre-bid guarantee. The contract should clearly exclude any form of guarantee or warranty regarding the estimates.

B. Construction Manager As Agent ("CMAA")

The CMAA is really nothing more than an independent owner's representative. The CMAA has no contractual liability for the design or the work. Although they may relieve the owner of the necessity of retaining in-house expertise, there is a cost. Generally, the CMAA charges a fee based upon a percentage of the project cost.

IV. PUBLIC-PRIVATE PARTNERSHIPS

During the 2006 Short Session, the North Carolina Legislature enacted Senate Bill 2009, which is codified at N.C. Gen. Stat. §115C-531, authorizing local Boards of Education to enter into capital leases with private developers for the use or construction of school property. This on the heels of the 2001 revision of N.C. Gen. Stat. §143-128 to allow North Carolina public entities to enter into Construction Manager at Risk (CMAR) contracts for the construction of public facilities. These changes demonstrate that the legislature is willing to allow significant departures from the traditional design-bid-build public contracting model. This article will examine the key features of each alternative delivery system and the relative advantages and disadvantages of each in comparison to the traditional public construction systems.

Public/Private Construction Contracts for School Construction

N.C. Gen. Stat. §115C-531 now allows for the private development of real property for use as school buildings or school facilities subject to capital leases on no longer than 40 years. The statute contemplates that the project and the property will be truly private projects. In this regard, the statute makes it explicit that the provisions of Article 2 of Chapter 44A are applicable to the project. In other words, contractors, subcontractors, and sub-subcontractors will have the right to lien the property and the

right to place a lien on funds in the same manner and subject to the same restrictions as on any other private property. This also means that the usual enforcement mechanism, i.e., sale of the property, is available for lien claims. In addition, the statute does not require the issuance of either performance or payment bonds on these projects.

Any construction, repair, or renovation that involves the expenditure of $300,000 or more is subject to the additional requirements of N.C. Gen. Stat. §115C-532. The statute refers to these projects as "Build-to-Suit Capital Leases." Prior to entering into a build-to-suit lease, the local board of education must adopt a resolution explicitly demonstrating that this delivery system is in the best interest of the school board.

In addition, for build-to-suit leases, all architectural, engineering, and survey services must be procured in compliance with Article 3D of Chapter 143, which requires the school board to identify the best qualified professionals without regard to fee and attempt to negotiate an acceptable price with the best qualified professional. For build-to-suit leases, there must be separate specifications for HVAC, plumbing and gas fittings, electrical wiring and installations, and other general construction, though there is no requirement that the construction be let to separate prime contractors for each division.

Build-to-suit lease construction also requires the developer to either solicit bids from prime contractors or select a construction manager at risk ("CMAR"). If the developer chooses a construction manager at risk, the CMAR must solicit bids for all work. There is no explicit requirement that the use of a CMAR is subject to the provisions of N.C. Gen. Stat. §143-128.1, which limits the CMAR's ability to self-perform, among other things. Likewise there is no specific qualification requirement for the selection of a CMAR, although the statute does state that the CMAR shall be selected

through a "qualification based process." Presumably this means that the provisions of N.C. Gen. Stat. §143-64.31 would apply. This provision requires the qualification of a professional services provided to be "without regard to fee." Whether these provisions together would require a private developer to negotiate first with the most qualified CMAR without any regard to fee remains an open question.

The developer or the CMAR may pre-qualify contractors based upon criteria determined by the local board of education. Regardless of whether the developer uses a CMAR, the project must be publicly advertised, the bids must be publicly opened, and the contract must be awarded to the lowest, responsible, responsive, and prequalified bidder.

The statute allows the local board of education to require the developer to provide a performance and payment bond in accordance with the provision for such bonds on public projects. In addition, the private developer must provide an irrevocable letter of credit for the benefit of laborers and materialmen in an amount not less than 5% of the total cost of the improvements. As a result of these provisions, the laborers and materialmen have the protection on build-to-suit projects of the ability to lien the property, the above-mentioned letter of credit, and, if required by the board of education, a payment bond issued on behalf of the private developer.

One final provision of interest allows the local school board, or any other local governmental entity, to sell, lease, or transfer property to the private developer for the purpose of constructing, repairing, or renovating a school pursuant to a build-to-suit lease. Pursuant to this provision, a local school board could sell any of its existing school properties in connection with a construction project that exceeds $300,000. Ordinarily, a

local school board cannot sell its properties without first declaring that the property is unnecessary or undesirable for public school purposes and offering the property for sale to the county before making it available to the public.

KEY CONTRACT TERMS THAT AFFECT CONSTRUCTION RISK

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I. PRICE/PAYMENT TERMS

a. Price

Following only the choice of delivery system as a broad determinant of the allocation of construction risk is the decision regarding how a project is to be priced. There are essentially three ways to price a project, with literally hundreds of possible variations. They are lump sum and cost plus, either with or without a guaranteed maximum price. The pricing mechanism that allocates the most risk to the contractor is the "lump sum" price. It is also the pricing mechanism that leads to more disputes and requires a very detailed description, in the form of drawings and specifications, to ensure that both parties understand what the contractor has agreed to build.

Using a lump sum or fixed price contract allows the owner to plan for the financial commitment with a greater degree of certainty and places a greater degree of the risk of unexpected costs on the contractor but the owner should expect that, all other things being equal, the project will carry a higher price to compensate the contractor for accepting those additional risks. In addition, because the better contractors will recognize these risks and price the contract for them, there is a greater likelihood that a contractor that is willing to gamble or cut corners may underbid the better builders. An owner should be wary of merely accepting the low bid under this scenario without ensuring that the lower bidder is going to deliver an acceptable product.

The second way to price a construction project calls for the contractor to be reimbursed for its costs plus a fee. The obvious risk to the owner of a cost-type contract

is that it bears the risk of cost escalation, estimate errors, and contractor inefficiencies. For these reasons, cost plus contracts often include a guaranteed maximum price. When the contract includes a guaranteed maximum price the owner continues to accept these risks but the upper limit of the risk is defined. Both the risk and potential rewards to the contractor are greater with a lump sum contract.

It is very important to understand the risks of each type of pricing mechanism and some of the contractual provisions designed to control those risks.

i. Lump Sum Contracts

As previously stated, lump sum or fixed price contracts shift most of the price risks to the contractor. For an established price, the contractor agrees to build the entire project. Therefore, the risks that material or equipment prices escalate, that the contractor is inefficient with labor, materials, or equipment and other price-related risks are no longer borne by the owner.

With most of the price-related risk on the contractor, the owner must ensure that the specifications are clear and do not allow for substitution of lesser quality materials. Although most of the price or cost-related risk is shifted to the contractor, the owner cannot assume that it can simply pay the contractor and will get the finished product. It is imperative that the contract establish payment terms that will align payments with the value of the work. This issue will be discussed in more detail below.

The final price of a lump sum contract can be altered through the use of allowances, unit prices, and change orders. As we have said, the cost or price risk is shifted to the contractor under a lump sum contract. However, even though the parties prefer this pricing mechanism there may be discrete parts of the construction that are

difficult to estimate or for some other reason the contractor is not willing to accept the price risk. Through the use of either allowances or unit prices, the cost risk on discrete portions of the contract can be allocated to the owner without losing the overall benefits of a lump sum contract.

An allowance is simply a guesstimate or plug number for the cost of some discrete portion of the contract. This portion of the contract is treated like a cost-based contract. The contractor keeps records of the actual costs expended and if the costs exceed the allowance then the owner pays the actual costs. In some, but not all contracts, if the costs for that portion of the work are less than the amount of the allowance, the lump sum contract price is reduced. In other contracts, the lump sum is increased if the cost exceeds the allowance but is not decreased if the costs are less than the allowance.

Likewise, some contracts use unit pricing for some of the work to allocate specific risks. For instance, where the parties may anticipate quantities of rock in the subsurface conditions but the geotechnical reports cannot accurately quantify the amount, the cost of performing the work may not be estimable with any degree of accuracy. In this situation the parties may agree on a fixed price for the subsurface work based upon an assumed quantity and establish a unit price for quantities that differ from the assumption. These provisions should define the assumptions and the unit pricing in some detail.

ii. Cost Plus Contracts

The owner retains much more of the cost-related risk in a cost plus contract, even when there is a guaranteed maximum price. If the contract calls for the contractor to be paid all of its costs plus a fee there is little, if any, incentive to control cut corners but there is also little incentive to control costs. This is why a favored contract method is a

cost plus contract that includes a guaranteed maximum price. As long as the fee is not a percentage of other costs, a savings sharing provision will provide an incentive to the contractor to control costs. Any provision designed to motivate cost savings, however, may also provide an incentive to lower quality.

With a cost plus contract there is also the much more complex question of which costs are reimbursable as costs and which should be considered part of the fee. The AIA standard cost plus contract is much longer and more detailed than the form lump sum contract. This added detail and length is a function of the need to define reimburseable costs. The form contract AIA A111 defines in great detail the costs that can be reimbursed and the costs that cannot be reimbursed.

A101 – Lump Sum

ARTICLE 2 THE WORK OF THIS CONTRACT

The Contractor shall fully execute the Work described in the Contract Documents, except to the extent specifically indicated in the Contract Documents to be the responsibility of others.

ARTICLE 4 CONTRACT SUM

§ 4.1 The Owner shall pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract. The Contract Sum shall be ($), subject to additions and deductions as provided in the Contract Documents.

§ 4.2 The Contract Sum is based upon the following alternates, if any, which are described in the Contract Documents and are hereby accepted by the Owner:
(State the numbers or other identification of accepted alternates. If decisions on other alternates are to be made by the Owner subsequent to the execution of this Agreement, attach a schedule of such other alternates showing the amount for each and the date when that amount expires)

§ 4.3 Unit prices, if any, are as follows:

Description	Units	Price ($ 0.00)

A111 – Cost plus a fee.

ARTICLE 5 BASIS FOR PAYMENT

§ 5.1 CONTRACT SUM

§ 5.1.1 The Owner shall pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract. The Contract Sum is the Cost of the Work as defined in Article 7 plus the Contractor's Fee.

§ 5.1.2 The Contractor's Fee is:
(State a lump sum, percentage of Cost of the Work or other provision for determining the Contractor's Fee, and describe the method of adjustment of the Contractor's Fee for changes in the Work.)

§ 5.2 GUARANTEED MAXIMUM PRICE

§ 5.2.1 The sum of the Cost of the Work and the Contractor's Fee is guaranteed by the Contractor not to exceed ($), subject to additions and deductions by Change Order as provided in the Contract Documents. Such maximum sum is referred to in the Contract Documents as the Guaranteed Maximum Price. Costs which would cause the Guaranteed Maximum Price to be exceeded shall be paid by the Contractor without reimbursement by the Owner.
(Insert specific provisions if the Contractor is to participate in any savings.)

§ 5.2.2 The Guaranteed Maximum Price is based on the following alternates, if any, which are described in the Contract Documents and are hereby accepted by the Owner:
(State the numbers or other identification of accepted alternates. If decisions on other alternates are to be made by the Owner subsequent to the execution of this Agreement, attach a schedule of such other alternates showing the amount for each and the date when the amount expires.)

§ 5.2.3 Unit prices, if any, are as follows:

Description	Units	Price ($ 0.00)

§ 5.2.4 Allowances, if any, are as follows
(Identify and state the amounts of any allowances, and state whether they include labor, materials, or both.)

Allowance	Amount ($ 0.00)	Included items

§ 5.2.5 Assumptions, if any, on which the Guaranteed Maximum Price is based are as follows:

§ 5.2.6 To the extent that the Drawings and Specifications are anticipated to require further development by the Architect, the Contractor has provided in the Guaranteed Maximum Price for such further development consistent with the Contract Documents and reasonably inferable therefrom. Such further development does not include such things as changes in scope, systems, kinds and quality of materials, finishes or equipment, all of which, if required, shall be incorporated by Change Order.

ARTICLE 7 COSTS TO BE REIMBURSED

§ 7.1 COST OF THE WORK

The term Cost of the Work shall mean costs necessarily incurred by the Contractor in the proper performance of the Work. Such costs shall be at rates not higher than the standard paid at the place of the Project except with prior consent of the Owner. The Cost of the Work shall include only the items set forth in this Article 7.

§ 7.2 LABOR COSTS

§ 7.2.1 Wages of construction workers directly employed by the Contractor to perform the construction of the Work at the site or, with the Owner's approval, at off-site workshops.

§ 7.2.2 Wages or salaries of the Contractor's supervisory and administrative personnel when stationed at the site with the Owner's approval.
(If it is intended that the wages or salaries of certain personnel stationed at the Contractor's principal or other offices shall be included in the Cost of the Work, identify in Article 14 the personnel to be included and whether for all or only part of their time, and the rates at which their time will be charged to the Work.)

§ 7.2.3 Wages and salaries of the Contractor's supervisory or administrative personnel engaged, at factories, workshops or on the road, in expediting the production or transportation of materials or equipment required for the Work, but only for that portion of their time required for the Work.

§ 7.2.4 Costs paid or incurred by the Contractor for taxes, insurance, contributions, assessments and benefits required by law or collective bargaining agreements and, for personnel not covered by such agreements, customary benefits such as sick leave, medical and health benefits, holidays, vacations and pensions, provided such costs are based on wages and salaries included in the Cost of the Work under Sections 7.2.1 through 7.2.3.

§ 7.3 SUBCONTRACT COSTS
§ 7.3.1 Payments made by the Contractor to Subcontractors in accordance with the requirements of the subcontracts.

§ 7.4 COSTS OF MATERIALS AND EQUIPMENT INCORPORATED IN THE COMPLETED CONSTRUCTION
§ 7.4.1 Costs, including transportation and storage, of materials and equipment incorporated or to be incorporated in the completed construction.

§ 7.4.2 Costs of materials described in the preceding Section 7.4.1 in excess of those actually installed to allow for reasonable waste and spoilage. Unused excess materials, if any, shall become the Owner's property at the completion of the Work or, at the Owner's option, shall be sold by the Contractor. Any amounts realized from such sales shall be credited to the Owner as a deduction from the Cost of the Work.

§ 7.5 COSTS OF OTHER MATERIALS AND EQUIPMENT, TEMPORARY FACILITIES AND RELATED ITEMS
§ 7.5.1 Costs, including transportation and storage, installation, maintenance, dismantling and removal of materials, supplies, temporary facilities, machinery, equipment, and hand tools not customarily owned by construction workers, that are provided by the Contractor at the site and fully consumed in the performance of the Work; and cost (less salvage value) of such items if not fully consumed, whether sold to others or retained by the Contractor. Cost for items previously used by the Contractor shall mean fair market value.

§ 7.5.2 Rental charges for temporary facilities, machinery, equipment, and hand tools not customarily owned by construction workers that are provided by the Contractor at the site, whether rented from the Contractor or others, and costs of transportation, installation, minor repairs and replacements, dismantling and removal thereof. Rates and quantities of equipment rented shall be subject to the Owner's prior approval.

§ 7.5.3 Costs of removal of debris from the site.

§ 7.5.4 Costs of document reproductions, facsimile transmissions and long-distance telephone calls, postage and parcel delivery charges, telephone service at the site and reasonable petty cash expenses of the site office.

§ 7.5.5 That portion of the reasonable expenses of the Contractor's personnel incurred while traveling in discharge of duties connected with the Work.

§ 7.5.6 Costs of materials and equipment suitably stored off the site at a mutually acceptable location, if approved in advance by the Owner.

§ 7.6 MISCELLANEOUS COSTS

§ 7.6.1 That portion of insurance and bond premiums that can be directly attributed to this Contract:

§ 7.6.2 Sales, use or similar taxes imposed by a governmental authority that are related to the Work.

§ 7.6.3 Fees and assessments for the building permit and for other permits, licenses and inspections for which the Contractor is required by the Contract Documents to pay.

§ 7.6.4 Fees of laboratories for tests required by the Contract Documents, except those related to defective or nonconforming Work for which reimbursement is excluded by Section 13.5.3 of AIA Document A201-1997 or other provisions of the Contract Documents, and which do not fall within the scope of Section 7.7.3.

§ 7.6.5 Royalties and license fees paid for the use of a particular design, process or product required by the Contract Documents; the cost of defending suits or claims for infringement of patent rights arising from such requirement of the Contract Documents; and payments made in accordance with legal judgments against the Contractor resulting from such suits or claims and payments of settlements made with the Owner's consent. However, such costs of legal defenses, judgments and settlements shall not be included in the calculation of the Contractor's Fee or subject to the Guaranteed Maximum Price. If such royalties, fees and costs are excluded by the last sentence of Section 3.17.1 of AIA Document A201-1997 or other provisions of the Contract Documents, then they shall not be included in the Cost of the Work.

§ 7.6.6 Data processing costs related to the Work.

§ 7.6.7 Deposits lost for causes other than the Contractor's negligence or failure to fulfill a specific responsibility to the Owner as set forth in the Contract Documents.

§ 7.6.8 Legal, mediation and arbitration costs, including attorneys' fees, other than those arising from disputes between the Owner and Contractor, reasonably incurred by the Contractor in the performance of the Work and with the Owner's prior written approval; which approval shall not be unreasonably withheld.

§ 7.6.9 Expenses incurred in accordance with the Contractor's standard personnel policy for relocation and temporary living allowances of personnel required for the Work, if approved by the Owner.

§ 7.7 OTHER COSTS AND EMERGENCIES

§ 7.7.1 Other costs incurred in the performance of the Work if and to the extent approved in advance in writing by the Owner.

§ 7.7.2 Costs due to emergencies incurred in taking action to prevent threatened damage, injury or loss in case of an emergency affecting the safety of persons and property, as provided in Section 10.6 of AIA Document A201-1997.

§ 7.7.3 Costs of repairing or correcting damaged or nonconforming Work executed by the Contractor, Subcontractors or suppliers, provided that such damaged or nonconforming Work was not caused by negligence or failure to fulfill a specific responsibility of the Contractor and only to the extent that the cost of repair or correction is not recoverable by the Contractor from insurance, sureties, Subcontractors or suppliers.

ARTICLE 8 COSTS NOT TO BE REIMBURSED

§ 8.1 The Cost of the Work shall not include:

§ 8.1.1 Salaries and other compensation of the Contractor's personnel stationed at the Contractor's principal office or offices other than the site office, except as specifically provided in Sections 7.2.2 and 7.2.3 or as may be provided in Article 14.

§ 8.1.2 Expenses of the Contractor's principal office and offices other than the site office.

§ 8.1.3 Overhead and general expenses, except as may be expressly included in Article 7.

§ 8.1.4 The Contractor's capital expenses, including interest on the Contractor's capital employed for the Work.

§ 8.1.5 Rental costs of machinery and equipment, except as specifically provided in Section 7.5.2.

§ 8.1.6 Except as provided in Section 7.7.3 of this Agreement, costs due to the negligence or failure to fulfill a specific responsibility of the Contractor, Subcontractors and suppliers or anyone directly or indirectly employed by any of them or for whose acts any of them may be liable.

§ 8.1.7 Any cost not specifically and expressly described in Article 7.

§ 8.1.8 Costs, other than costs included in Change Orders approved by the Owner, that would cause the Guaranteed Maximum Price to be exceeded.

ARTICLE 9 DISCOUNTS, REBATES AND REFUNDS

§ 9.1 Cash discounts obtained on payments made by the Contractor shall accrue to the Owner if (1) before making the payment, the Contractor included them in an Application for Payment and received payment therefor from the Owner, or (2) the Owner has deposited funds with the Contractor with which to make payments; otherwise, cash discounts shall accrue to the Contractor. Trade discounts, rebates, refunds and amounts received from sales of surplus materials and equipment shall accrue to the Owner, and the Contractor shall make provisions so that they can be secured.

§ 9.2 Amounts that accrue to the Owner in accordance with the provisions of Section 9.1 shall be credited to the Owner as a deduction from the Cost of the Work.

A201

§ 3.3 SUPERVISION AND CONSTRUCTION PROCEDURES

§ 3.3.1 The Contractor shall supervise and direct the Work, using the Contractor's best skill and attention. The Contractor shall be solely responsible for and have control over construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work under the Contract, unless the Contract Documents give other specific instructions concerning these matters. If the Contract Documents give specific instructions concerning construction means, methods, techniques, sequences or procedures, the Contractor shall evaluate the jobsite safety thereof and, except as stated below, shall be fully and solely responsible for the jobsite safety of such means, methods, techniques, sequences or procedures. If the Contractor determines that such means, methods, techniques, sequences or procedures may not be safe, the Contractor shall give timely written notice to the Owner and Architect and shall not proceed with that portion of the Work without further written instructions from the Architect. If the Contractor is then instructed to proceed with the required means, methods, techniques, sequences or procedures without acceptance of changes proposed by the Contractor, the Owner shall be solely responsible for any resulting loss or damage.

§ 3.3.2 The Contractor shall be responsible to the Owner for acts and omissions of the Contractor's employees, Subcontractors and their agents and employees, and other persons or entities performing portions of the Work for or on behalf of the Contractor or any of its Subcontractors.

§ 3.3.3 The Contractor shall be responsible for inspection of portions of Work already performed to determine that such portions are in proper condition to receive subsequent Work.

§ 3.4 LABOR AND MATERIALS

§ 3.4.1 Unless otherwise provided in the Contract Documents, the Contractor shall provide and pay for labor, materials, equipment, tools, construction equipment and machinery, water, heat, utilities,

transportation, and other facilities and services necessary for proper execution and completion of the Work, whether temporary or permanent and whether or not incorporated or to be incorporated in the Work.

§ 3.4.2 The Contractor may make substitutions only with the consent of the Owner, after evaluation by the Architect and in accordance with a Change Order.

§ 3.4.3 The Contractor shall enforce strict discipline and good order among the Contractor's employees and other persons carrying out the Contract. The Contractor shall not permit employment of unfit persons or persons not skilled in tasks assigned to them.

§ 3.6 TAXES

§ 3.6.1 The Contractor shall pay sales, consumer, use and similar taxes for the Work provided by the Contractor which are legally enacted when bids are received or negotiations concluded, whether or not yet effective or merely scheduled to go into effect.

§ 3.7 PERMITS, FEES AND NOTICES

§ 3.7.1 Unless otherwise provided in the Contract Documents, the Contractor shall secure and pay for the building permit and other permits and governmental fees, licenses and inspections necessary for proper execution and completion of the Work which are customarily secured after execution of the Contract and which are legally required when bids are received or negotiations concluded.

§ 3.7.2 The Contractor shall comply with and give notices required by laws, ordinances, rules, regulations and lawful orders of public authorities applicable to performance of the Work.

§ 3.7.3 It is not the Contractor's responsibility to ascertain that the Contract Documents are in accordance with applicable laws, statutes, ordinances, building codes, and rules and regulations. However, if the Contractor observes that portions of the Contract Documents are at variance therewith, the Contractor shall promptly notify the Architect and Owner in writing, and necessary changes shall be accomplished by appropriate Modification.

§ 3.7.4 If the Contractor performs Work knowing it to be contrary to laws, statutes, ordinances, building codes, and rules and regulations without such notice to the Architect and Owner, the Contractor shall assume appropriate responsibility for such Work and shall bear the costs attributable to correction.

§ 3.8 ALLOWANCES

§ 3.8.1 The Contractor shall include in the Contract Sum all allowances stated in the Contract Documents. Items covered by allowances shall be supplied for such amounts and by such persons or entities as the Owner may direct, but the Contractor shall not be required to employ persons or entities to whom the Contractor has reasonable objection.

§ 3.8.2 Unless otherwise provided in the Contract Documents:

- **.1** allowances shall cover the cost to the Contractor of materials and equipment delivered at the site and all required taxes, less applicable trade discounts;
- **.2** Contractor's costs for unloading and handling at the site, labor, installation costs, overhead, profit and other expenses contemplated for stated allowance amounts shall be included in the Contract Sum but not in the allowances;
- **.3** whenever costs are more than or less than allowances, the Contract Sum shall be adjusted accordingly by Change Order. The amount of the Change Order shall reflect (1) the difference between actual costs and the allowances under Section 3.8.2.1 and (2) changes in Contractor's costs under Section 3.8.2.2.

§ 3.8.3 Materials and equipment under an allowance shall be selected by the Owner in sufficient time to avoid delay in the Work.

§ 3.9 SUPERINTENDENT

§ 3.9.1 The Contractor shall employ a competent superintendent and necessary assistants who shall be in attendance at the Project site during performance of the Work. The superintendent shall represent the Contractor, and communications given to the superintendent shall be as binding as if given to the Contractor. Important communications shall be confirmed in writing. Other communications shall be similarly confirmed on written request in each case.

b. Payment Terms

"Money is the lifeline in construction. Like political campaign contributions, payments are the mother's milk of construction. Of course, payment is crucial in *any* transaction. But in a chronically sick, low-profit-margin activity like construction, it is particularly vital." SWEET ON CONSTRUCTION LAW (ABA 1997), p. 152. A good construction contract balances the contractor's need to pay for the progress of the work and the owner's need to ensure that the contractor continues to perform and complete the project. Therefore, ordinarily the contractor will be paid periodically in what the industry calls "Progress Payments." Under ordinary circumstances, construction payments are not made in advance of the work. As a result, if properly monitored the owner is only paying for materials actually purchased and on site or labor and equipment costs actually expended. As a result, the contractor – or its suppliers – are financing the project in part.

This follows from the general common law rule in service contracts that all of the service must be performed before payment is due. Of course, very few, if any contractors could finance a construction project with only their lien rights as security for the debt. Therefore, the custom arose that the contractor is paid periodically for a portion of the work.

Legally, however, it is important to note that the progress payments are not considered full payment for the work performed. Instead, based upon a formula agreed to under the contract, the contractor is being paid a part of the total contract price. The

distinction is not meaningful during the course of the project or if the contractor completes the contract as planned. It is a significant distinction, however, if the contract is terminated prior to completion. If the contract is well written and the owner or her representative monitors the process accurately, the partial payment should approximate the quantity of work in place.

i. Schedules of Values

Ordinarily the contract should require the contractor to prepare a schedule of values allocating the entire cost of the project to specific aspects of the work. The appropriate level of detail will vary by the type and complexity of the work. Progress payments on lump sum contracts and cost plus contracts when subject to a guaranteed maximum price should be based upon the schedule of values. Once the schedule of values is established, the contract should establish that all periodic payments are to be based upon the percentage completion of each portion of the work. In other words, if site work is five percent of the contract value, the contractor would be entitled to payment of five percent of the contract value when that work is completed.

Although not usually required to justify payment on a straight cost plus contract, it is a good planning and monitoring tool to require costs to be allocated against the contractor's estimate broken down in a schedule of values.

Under the AIA scheme, the contractor must present its Application for Payment, including the schedule of values to the architect. The architect is required to evaluate the application and issue a Certificate for Payment in the amount to which it believes the contractor is entitled.

ii. Retainage

Another form of protection for the owner is the retention of a percentage of the amount earned by the contractor from each pay application. Retainage provides the owner with protection against liens by subcontractors or suppliers and against default by the contractor. It also gives the contractor extra incentive to complete the project. The amount withheld should be sufficient to provide these protections and incentives but should not be so large as to be punitive. The correct percentage will differ from project to project depending upon a number of factors, including the financial strength and reputation of the contractor.

Many contractors will expect some provision in the contract for the early release or reduction of retainage. The contract should provide for the early reduction of retainage giving due consideration to the purposes of the retainage. For instance, if the nature of the project is such that the value of the retention at substantial completion is likely to greatly exceed the likely cost to complete the contract should provide for a reduction. This decision may be written into the contract but can also be left to the discretion of the owner at some subsequent time.

iii. Lien Waivers and Contractor Certification/Waivers

Although the AIA form contract does not require lien waivers as a part of the Application for Payment, we believe that this should be a requirement in every construction contract without exception. The contractor should be required to submit partial, conditional lien waivers from every subcontractor and supplier that has performed work or supplied materials or equipment with each and every Application.

The contract should also require the Application for Payment to include a Contractor's Certification that it is aware of no materialmen's lien or any pending dispute related to the work covered by the Application. Where possible, the contract should also require the contractor to explicitly waive any claims for extensions of time or additional compensation related to work performed prior to the date of the Application except those for which the contractor has given written notice with or prior to each Application.

iv. Other Documentation

Additional protection should be required in the form of additional documentation that should be required as a prerequisite for payment. In our view, the contract should require the contractor to provide all or some combination of the following documentation in support of each Application for Payment: 1) an accurate, updated schedule; 2) a Contractor's Status Report, including a statement of the work performed, a review of the prospect for timely completion, including any plan to recover lost time; 3) a statement of all pending change orders; 4) a detailed statement of any claims that the contractor expects to arise; and, 5) identification of any pending or expected issues that will require decisions or approvals by the owner or designer.

A101 – Lump Sum
ARTICLE 5 PAYMENTS
§ 5.1 PROGRESS PAYMENTS
§ 5.1.1 Based upon Applications for Payment submitted to the Architect by the Contractor and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Contractor as provided below and elsewhere in the Contract Documents.

§ 5.1.2 The period covered by each Application for Payment shall be one calendar month ending on the last day of the month, or as follows:

§ 5.1.3 Provided that an Application for Payment is received by the Architect not later than the day of a month, the Owner shall make payment to the Contractor not later than the day of the same month. If an Application for Payment is received by the Architect after the application date fixed above, payment

shall be made by the Owner not later than ( ) days after the Architect receives the Application for Payment.

§ 5.1.4 Each Application for Payment shall be based on the most recent schedule of values submitted by the Contractor in accordance with the Contract Documents. The schedule of values shall allocate the entire Contract Sum among the various portions of the Work. The schedule of values shall be prepared in such form and supported by such data to substantiate its accuracy as the Architect may require. This schedule, unless objected to by the Architect, shall be used as a basis for reviewing the Contractor's Applications for Payment.

§ 5.1.5 Applications for Payment shall indicate the percentage of completion of each portion of the Work as of the end of the period covered by the Application for Payment.

§ 5.1.6 Subject to other provisions of the Contract Documents, the amount of each progress payment shall be computed as follows:

.1 Take that portion of the Contract Sum properly allocable to completed Work as determined by multiplying the percentage completion of each portion of the Work by the share of the Contract Sum allocated to that portion of the Work in the schedule of values, less retainage of ( ). Pending final determination of cost to the Owner of changes in the Work, amounts not in dispute shall be included as provided in Section 7.3.8 of AIA Document A201-1997;

.2 Add that portion of the Contract Sum properly allocable to materials and equipment delivered and suitably stored at the site for subsequent incorporation in the completed construction (or, if approved in advance by the Owner, suitably stored off the site at a location agreed upon in writing), less retainage of ( );

.3 Subtract the aggregate of previous payments made by the Owner; and

.4 Subtract amounts, if any, for which the Architect has withheld or nullified a Certificate for Payment as provided in Section 9.5 of AIA Document A201-1997.

§ 5.1.7 The progress payment amount determined in accordance with Section 5.1.6 shall be further modified under the following circumstances:

.1 Add, upon Substantial Completion of the Work, a sum sufficient to increase the total payments to the full amount of the Contract Sum, less such amounts as the Architect shall determine for incomplete Work, retainage applicable to such work and unsettled claims; and *(Section 9.8.5 of AIA Document A201-1997 requires release of applicable retainage upon Substantial Completion of Work with consent of surety, if any.)*

.2 Add, if final completion of the Work is thereafter materially delayed through no fault of the Contractor, any additional amounts payable in accordance with Section 9.10.3 of AIA Document A201-1997.

§ 5.1.8 Reduction or limitation of retainage, if any, shall be as follows:
(If it is intended, prior to Substantial Completion of the entire Work, to reduce or limit the retainage resulting from the percentages inserted in Sections 5.1.6.1 and 5.1.6.2 above, and this is not explained elsewhere in the Contract Documents, insert here provisions for such reduction or limitation.)

§ 5.1.9 Except with the Owner's prior approval, the Contractor shall not make advance payments to suppliers for materials or equipment which have not been delivered and stored at the site.

§ 5.2 FINAL PAYMENT

§ 5.2.1 Final payment, constituting the entire unpaid balance of the Contract Sum, shall be made by the Owner to the Contractor when:

.1 the Contractor has fully performed the Contract except for the Contractor's responsibility to correct Work as provided in Section 12.2.2 of AIA Document A201-1997, and to satisfy other requirements, if any, which extend beyond final payment; and

.2 a final Certificate for Payment has been issued by the Architect.

§ 5.2.2 The Owner's final payment to the Contractor shall be made no later than 30 days after the issuance of the Architect's final Certificate for Payment, or as follows:

A111 – Cost Plus A Fee

ARTICLE 12 PAYMENTS

§ 12.1 PROGRESS PAYMENTS

§ 12.1.1 Based upon Applications for Payment submitted to the Architect by the Contractor and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Contractor as provided below and elsewhere in the Contract Documents.

§ 12.1.2 The period covered by each Application for Payment shall be one calendar month ending on the last day of the month, or as follows:

§ 12.1.3 Provided that an Application for Payment is received by the Architect not later than the day of a month, the Owner shall make payment to the Contractor not later than the day of the same month. If an Application for Payment is received by the Architect after the application date fixed above, payment shall be made by the Owner not later than ( ) days after the Architect receives the Application for Payment.

§ 12.1.4 With each Application for Payment, the Contractor shall submit payrolls, petty cash accounts, receipted invoices or invoices with check vouchers attached, and any other evidence required by the Owner or Architect to demonstrate that cash disbursements already made by the Contractor on account of the Cost of the Work equal or exceed (1) progress payments already received by the Contractor; less (2) that portion of those payments attributable to the Contractor's Fee; plus (3) payrolls for the period covered by the present Application for Payment.

§ 12.1.5 Each Application for Payment shall be based on the most recent schedule of values submitted by the Contractor in accordance with the Contract Documents. The schedule of values shall allocate the entire Guaranteed Maximum Price among the various portions of the Work, except that the Contractor's Fee shall be shown as a single separate item. The schedule of values shall be prepared in such form and supported by such data to substantiate its accuracy as the Architect may require. This schedule, unless objected to by the Architect, shall be used as a basis for reviewing the Contractor's Applications for Payment.

§ 12.1.6 Applications for Payment shall show the percentage of completion of each portion of the Work as of the end of the period covered by the Application for Payment. The percentage of completion shall be the lesser of (1) the percentage of that portion of the Work which has actually been completed; or (2) the percentage obtained by dividing (a) the expense that has actually been incurred by the Contractor on account of that portion of the Work for which the Contractor has made or intends to make actual payment prior to the next Application for Payment by (b) the share of the Guaranteed Maximum Price allocated to that portion of the Work in the schedule of values.

§ 12.1.7 Subject to other provisions of the Contract Documents, the amount of each progress payment shall be computed as follows:

.1 take that portion of the Guaranteed Maximum Price properly allocable to completed Work as determined by multiplying the percentage of completion of each portion of the Work by the share of the Guaranteed Maximum Price allocated to that portion of the Work in the schedule of values. Pending final determination of cost to the Owner of changes in the Work, amounts not in dispute shall be included as provided in Section 7.3.8 of AIA Document A201-1997;

.2 add that portion of the Guaranteed Maximum Price properly allocable to materials and equipment delivered and suitably stored at the site for subsequent incorporation in the Work, or if approved in advance by the Owner, suitably stored off the site at a location agreed upon in writing;

.3 add the Contractor's Fee, less retainage of ( ).The Contractor's Fee shall be computed upon the Cost of the Work described in the two preceding Clauses at the rate stated in Section 5.1.2 or, if the Contractor's Fee is stated as a fixed sum in that Subparagraph, shall be an amount that bears the same ratio to that fixed-sum fee as the Cost of the Work in the two preceding Clauses bears to a reasonable estimate of the probable Cost of the Work upon its completion;

.4 subtract the aggregate of previous payments made by the Owner;

.5 subtract the shortfall, if any, indicated by the Contractor in the documentation required by Section 12.1.4 to substantiate prior Applications for Payment, or resulting from errors subsequently discovered by the Owner's accountants in such documentation; and

.6 subtract amounts, if any, for which the Architect has withheld or nullified a Certificate for Payment as provided in Section 9.5 of AIA Document A201-1997.

§ 12.1.8 Except with the Owner's prior approval, payments to Subcontractors shall be subject to retainage of not less than ( ). The Owner and the Contractor shall agree upon a mutually acceptable procedure for review and approval of payments and retention for Subcontractors.

§ 12.1.9 In taking action on the Contractor's Applications for Payment, the Architect shall be entitled to rely on the accuracy and completeness of the information furnished by the Contractor and shall not be deemed to represent that the Architect has made a detailed examination, audit or arithmetic verification of the documentation submitted in accordance with Section 12.1.4 or other supporting data; that the Architect has made exhaustive or continuous on-site inspections or that the Architect has made examinations to ascertain how or for what purposes the Contractor has used amounts previously paid on account of the Contract. Such examinations, audits and verifications, if required by the Owner, will be performed by the Owner's accountants acting in the sole interest of the Owner.

§ 12.2 FINAL PAYMENT

§ 12.2.1 Final payment, constituting the entire unpaid balance of the Contract Sum, shall be made by the Owner to the Contractor when:

.1 the Contractor has fully performed the Contract except for the Contractor's responsibility to correct Work as provided in Section 12.2.2 of AIA Document A201-1997, and to satisfy other requirements, if any, which extend beyond final payment; and

.2 a final Certificate for Payment has been issued by the Architect.

§ 12.2.2 The Owner's final payment to the Contractor shall be made no later than 30 days after the issuance of the Architect's final Certificate for Payment, or as follows:

§ 12.2.3 The Owner's accountants will review and report in writing on the Contractor's final accounting within 30 days after delivery of the final accounting to the Architect by the Contractor. Based upon such Cost of the Work as the Owner's accountants report to be substantiated by the Contractor's final accounting, and provided the other conditions of Section 12.2.1 have been met, the Architect will, within seven days after receipt of the written report of the Owner's accountants, either issue to the Owner a final Certificate for Payment with a copy to the Contractor, or notify the Contractor and Owner in writing of the Architect's reasons for withholding a certificate as provided in Section 9.5.1 of the AIA Document A201-1997. The time periods stated in this Section 12.2.3 supersede those stated in Section 9.4.1 of the AIA Document A201-1997.

§ 12.2.4 If the Owner's accountants report the Cost of the Work as substantiated by the Contractor's final accounting to be less than claimed by the Contractor, the Contractor shall be entitled to demand arbitration of the disputed amount without a further decision of the Architect. Such demand for arbitration shall be made by the Contractor within 30 days after the Contractor's receipt of a copy of the Architect's final Certificate for Payment; failure to demand arbitration within this 30-day period shall result in the substantiated amount reported by the Owner's accountants becoming binding on the Contractor. Pending a final resolution by arbitration, the Owner shall pay the Contractor the amount certified in the Architect's final Certificate for Payment.

§ 12.2.5 If, subsequent to final payment and at the Owner's request, the Contractor incurs costs described in Article 7 and not excluded by Article 8 to correct defective or nonconforming Work, the Owner shall reimburse the Contractor such costs and the Contractor's Fee applicable thereto on the same basis as if such costs had been incurred prior to final payment, but not in excess of the Guaranteed Maximum Price. If the Contractor has participated in savings as provided in Section 5.2, the amount of such savings shall be recalculated and appropriate credit given to the Owner in determining the net amount to be paid by the Owner to the Contractor.

A201
ARTICLE 9 PAYMENTS AND COMPLETION

§ 9.1 CONTRACT SUM

§ 9.1.1 The Contract Sum is stated in the Agreement and, including authorized adjustments, is the total amount payable by the Owner to the Contractor for performance of the Work under the Contract Documents.

§ 9.2 SCHEDULE OF VALUES

§ 9.2.1 Before the first Application for Payment, the Contractor shall submit to the Architect a schedule of values allocated to various portions of the Work, prepared in such form and supported by such data to substantiate its accuracy as the Architect may require. This schedule, unless objected to by the Architect, shall be used as a basis for reviewing the Contractor's Applications for Payment.

§ 9.3 APPLICATIONS FOR PAYMENT

§ 9.3.1 At least ten days before the date established for each progress payment, the Contractor shall submit to the Architect an itemized Application for Payment for operations completed in accordance with the schedule of values. Such application shall be notarized, if required, and supported by such data substantiating the Contractor's right to payment as the Owner or Architect may require, such as copies of requisitions from Subcontractors and material suppliers, and reflecting retainage if provided for in the Contract Documents.

§ 9.3.1.1 As provided in Section 7.3.8, such applications may include requests for payment on account of changes in the Work which have been properly authorized by Construction Change Directives, or by interim determinations of the Architect, but not yet included in Change Orders.

§ 9.3.1.2 Such applications may not include requests for payment for portions of the Work for which the Contractor does not intend to pay to a Subcontractor or material supplier, unless such Work has been performed by others whom the Contractor intends to pay.

§ 9.3.2 Unless otherwise provided in the Contract Documents, payments shall be made on account of materials and equipment delivered and suitably stored at the site for subsequent incorporation in the Work. If approved in advance by the Owner, payment may similarly be made for materials and equipment suitably stored off the site at a location agreed upon in writing. Payment for materials and equipment stored on or off the site shall be conditioned upon compliance by the Contractor with procedures satisfactory to the Owner to establish the Owner's title to such materials and equipment or otherwise protect the Owner's interest, and shall include the costs of applicable insurance, storage and transportation to the site for such materials and equipment stored off the site.

§ 9.3.3 The Contractor warrants that title to all Work covered by an Application for Payment will pass to the Owner no later than the time of payment. The Contractor further warrants that upon submittal of an Application for Payment all Work for which Certificates for Payment have been previously issued and payments received from the Owner shall, to the best of the Contractor's knowledge, information and belief, be free and clear of liens, claims, security interests or encumbrances in favor of the Contractor, Subcontractors, material suppliers, or other persons or entities making a claim by reason of having provided labor, materials and equipment relating to the Work.

§ 9.4 CERTIFICATES FOR PAYMENT

§ 9.4.1 The Architect will, within seven days after receipt of the Contractor's Application for Payment, either issue to the Owner a Certificate for Payment, with a copy to the Contractor, for such amount as the Architect determines is properly due, or notify the Contractor and Owner in writing of the Architect's reasons for withholding certification in whole or in part as provided in Section 9.5.1.

§ 9.4.2 The issuance of a Certificate for Payment will constitute a representation by the Architect to the Owner, based on the Architect's evaluation of the Work and the data comprising the Application for Payment, that the Work has progressed to the point indicated and that, to the best of the Architect's knowledge, information and belief, the quality of the Work is in accordance with the Contract Documents. The foregoing representations are subject to an evaluation of the Work for conformance with the Contract Documents upon Substantial Completion, to results of subsequent tests and inspections, to correction of minor deviations from the Contract Documents prior to completion and to specific qualifications expressed by the Architect. The issuance of a Certificate for Payment will further constitute a representation that the Contractor is entitled to payment in the amount certified. However, the issuance of a Certificate for Payment will not be a representation that the Architect has (1) made exhaustive or continuous on-site inspections to check the quality or quantity of the Work, (2) reviewed construction means, methods, techniques, sequences or procedures, (3) reviewed copies of requisitions received from Subcontractors and material suppliers and other data requested by the Owner to substantiate the Contractor's right to payment, or (4) made examination to ascertain how or for what purpose the Contractor has used money previously paid on account of the Contract Sum.

§ 9.5 DECISIONS TO WITHHOLD CERTIFICATION

§ 9.5.1 The Architect may withhold a Certificate for Payment in whole or in part, to the extent reasonably necessary to protect the Owner, if in the Architect's opinion the representations to the Owner required by Section 9.4.2 cannot be made. If the Architect is unable to certify payment in the amount of the Application, the Architect will notify the Contractor and Owner as provided in Section 9.4.1. If the Contractor and Architect cannot agree on a revised amount, the Architect will promptly issue a Certificate for Payment for the amount for which the Architect is able to make such representations to the Owner. The Architect may also withhold a Certificate for Payment or, because of subsequently discovered evidence, may nullify the whole or a part of a Certificate for Payment previously issued, to such extent as may be

necessary in the Architect's opinion to protect the Owner from loss for which the Contractor is responsible, including loss resulting from acts and omissions described in Section 3.3.2, because of:

- **.1** defective Work not remedied;
- **.2** third party claims filed or reasonable evidence indicating probable filing of such claims unless security acceptable to the Owner is provided by the Contractor;
- **.3** failure of the Contractor to make payments properly to Subcontractors or for labor, materials or equipment;
- **.4** reasonable evidence that the Work cannot be completed for the unpaid balance of the Contract Sum;
- **.5** damage to the Owner or another contractor;
- **.6** reasonable evidence that the Work will not be completed within the Contract Time, and that the unpaid balance would not be adequate to cover actual or liquidated damages for the anticipated delay; or
- **.7** persistent failure to carry out the Work in accordance with the Contract Documents.

§ 9.5.2 When the above reasons for withholding certification are removed, certification will be made for amounts previously withheld.

§ 9.6 PROGRESS PAYMENTS

§ 9.6.1 After the Architect has issued a Certificate for Payment, the Owner shall make payment in the manner and within the time provided in the Contract Documents, and shall so notify the Architect.

§ 9.6.2 The Contractor shall promptly pay each Subcontractor, upon receipt of payment from the Owner, out of the amount paid to the Contractor on account of such Subcontractor's portion of the Work, the amount to which said Subcontractor is entitled, reflecting percentages actually retained from payments to the Contractor on account of such Subcontractor's portion of the Work. The Contractor shall, by appropriate agreement with each Subcontractor, require each Subcontractor to make payments to Sub-subcontractors in a similar manner.

§ 9.6.3 The Architect will, on request, furnish to a Subcontractor, if practicable, information regarding percentages of completion or amounts applied for by the Contractor and action taken thereon by the Architect and Owner on account of portions of the Work done by such Subcontractor.

§ 9.6.4 Neither the Owner nor Architect shall have an obligation to pay or to see to the payment of money to a Subcontractor except as may otherwise be required by law.

§ 9.6.5 Payment to material suppliers shall be treated in a manner similar to that provided in Sections 9.6.2, 9.6.3 and 9.6.4.

§ 9.6.6 A Certificate for Payment, a progress payment, or partial or entire use or occupancy of the Project by the Owner shall not constitute acceptance of Work not in accordance with the Contract Documents.

§ 9.6.7 Unless the Contractor provides the Owner with a payment bond in the full penal sum of the Contract Sum, payments received by the Contractor for Work properly performed by Subcontractors and suppliers shall be held by the Contractor for those Subcontractors or suppliers who performed Work or furnished materials, or both, under contract with the Contractor for which payment was made by the Owner. Nothing contained herein shall require money to be placed in a separate account and not commingled with money of the Contractor, shall create any fiduciary liability or tort liability on the part of the Contractor for breach of trust or shall entitle any person or entity to an award of punitive damages against the Contractor for breach of the requirements of this provision.

§ 9.7 FAILURE OF PAYMENT

§ 9.7.1 If the Architect does not issue a Certificate for Payment, through no fault of the Contractor, within seven days after receipt of the Contractor's Application for Payment, or if the Owner does not pay the Contractor within seven days after the date established in the Contract Documents the amount certified by the Architect or awarded by arbitration, then the Contractor may, upon seven additional days' written notice

to the Owner and Architect, stop the Work until payment of the amount owing has been received. The Contract Time shall be extended appropriately and the Contract Sum shall be increased by the amount of the Contractor's reasonable costs of shut-down, delay and start-up, plus interest as provided for in the Contract Documents.

§ 9.8 SUBSTANTIAL COMPLETION

§ 9.8.1 Substantial Completion is the stage in the progress of the Work when the Work or designated portion thereof is sufficiently complete in accordance with the Contract Documents so that the Owner can occupy or utilize the Work for its intended use.

§ 9.8.2 When the Contractor considers that the Work, or a portion thereof which the Owner agrees to accept separately, is substantially complete, the Contractor shall prepare and submit to the Architect a comprehensive list of items to be completed or corrected prior to final payment. Failure to include an item on such list does not alter the responsibility of the Contractor to complete all Work in accordance with the Contract Documents.

§ 9.8.3 Upon receipt of the Contractor's list, the Architect will make an inspection to determine whether the Work or designated portion thereof is substantially complete. If the Architect's inspection discloses any item, whether or not included on the Contractor's list, which is not sufficiently complete in accordance with the Contract Documents so that the Owner can occupy or utilize the Work or designated portion thereof for its intended use, the Contractor shall, before issuance of the Certificate of Substantial Completion, complete or correct such item upon notification by the Architect. In such case, the Contractor shall then submit a request for another inspection by the Architect to determine Substantial Completion.

§ 9.8.4 When the Work or designated portion thereof is substantially complete, the Architect will prepare a Certificate of Substantial Completion which shall establish the date of Substantial Completion, shall establish responsibilities of the Owner and Contractor for security, maintenance, heat, utilities, damage to the Work and insurance, and shall fix the time within which the Contractor shall finish all items on the list accompanying the Certificate. Warranties required by the Contract Documents shall commence on the date of Substantial Completion of the Work or designated portion thereof unless otherwise provided in the Certificate of Substantial Completion.

§ 9.8.5 The Certificate of Substantial Completion shall be submitted to the Owner and Contractor for their written acceptance of responsibilities assigned to them in such Certificate. Upon such acceptance and consent of surety, if any, the Owner shall make payment of retainage applying to such Work or designated portion thereof. Such payment shall be adjusted for Work that is incomplete or not in accordance with the requirements of the Contract Documents.

§ 9.9 PARTIAL OCCUPANCY OR USE

§ 9.9.1 The Owner may occupy or use any completed or partially completed portion of the Work at any stage when such portion is designated by separate agreement with the Contractor, provided such occupancy or use is consented to by the insurer as required under Section 11.4.1.5 and authorized by public authorities having jurisdiction over the Work. Such partial occupancy or use may commence whether or not the portion is substantially complete, provided the Owner and Contractor have accepted in writing the responsibilities assigned to each of them for payments, retainage, if any, security, maintenance, heat, utilities, damage to the Work and insurance, and have agreed in writing concerning the period for correction of the Work and commencement of warranties required by the Contract Documents. When the Contractor considers a portion substantially complete, the Contractor shall prepare and submit a list to the Architect as provided under Section 9.8.2. Consent of the Contractor to partial occupancy or use shall not be unreasonably withheld. The stage of the progress of the Work shall be determined by written agreement between the Owner and Contractor or, if no agreement is reached, by decision of the Architect.

§ 9.9.2 Immediately prior to such partial occupancy or use, the Owner, Contractor and Architect shall jointly inspect the area to be occupied or portion of the Work to be used in order to determine and record the condition of the Work.

§ 9.9.3 Unless otherwise agreed upon, partial occupancy or use of a portion or portions of the Work shall not constitute acceptance of Work not complying with the requirements of the Contract Documents.

§ 9.10 FINAL COMPLETION AND FINAL PAYMENT

§ 9.10.1 Upon receipt of written notice that the Work is ready for final inspection and acceptance and upon receipt of a final Application for Payment, the Architect will promptly make such inspection and, when the Architect finds the Work acceptable under the Contract Documents and the Contract fully performed, the Architect will promptly issue a final Certificate for Payment stating that to the best of the Architect's knowledge, information and belief, and on the basis of the Architect's on-site visits and inspections, the Work has been completed in accordance with terms and conditions of the Contract Documents and that the entire balance found to be due the Contractor and noted in the final Certificate is due and payable. The Architect's final Certificate for Payment will constitute a further representation that conditions listed in Section 9.10.2 as precedent to the Contractor's being entitled to final payment have been fulfilled.

§ 9.10.2 Neither final payment nor any remaining retained percentage shall become due until the Contractor submits to the Architect (1) an affidavit that payrolls, bills for materials and equipment, and other indebtedness connected with the Work for which the Owner or the Owner's property might be responsible or encumbered (less amounts withheld by Owner) have been paid or otherwise satisfied, (2) a certificate evidencing that insurance required by the Contract Documents to remain in force after final payment is currently in effect and will not be canceled or allowed to expire until at least 30 days' prior written notice has been given to the Owner, (3) a written statement that the Contractor knows of no substantial reason that the insurance will not be renewable to cover the period required by the Contract Documents, (4) consent of surety, if any, to final payment and (5), if required by the Owner, other data establishing payment or satisfaction of obligations, such as receipts, releases and waivers of liens, claims, security interests or encumbrances arising out of the Contract, to the extent and in such form as may be designated by the Owner. If a Subcontractor refuses to furnish a release or waiver required by the Owner, the Contractor may furnish a bond satisfactory to the Owner to indemnify the Owner against such lien. If such lien remains unsatisfied after payments are made, the Contractor shall refund to the Owner all money that the Owner may be compelled to pay in discharging such lien, including all costs and reasonable attorneys' fees.

§ 9.10.3 If, after Substantial Completion of the Work, final completion thereof is materially delayed through no fault of the Contractor or by issuance of Change Orders affecting final completion, and the Architect so confirms, the Owner shall, upon application by the Contractor and certification by the Architect, and without terminating the Contract, make payment of the balance due for that portion of the Work fully completed and accepted. If the remaining balance for Work not fully completed or corrected is less than retainage stipulated in the Contract Documents, and if bonds have been furnished, the written consent of surety to payment of the balance due for that portion of the Work fully completed and accepted shall be submitted by the Contractor to the Architect prior to certification of such payment. Such payment shall be made under terms and conditions governing final payment, except that it shall not constitute a waiver of claims.

§ 9.10.4 The making of final payment shall constitute a waiver of Claims by the Owner except those arising from:

- **.1** liens, Claims, security interests or encumbrances arising out of the Contract and unsettled;
- **.2** failure of the Work to comply with the requirements of the Contract Documents; or
- **.3** terms of special warranties required by the Contract Documents.

§ 9.10.5 Acceptance of final payment by the Contractor, a Subcontractor or material supplier shall constitute a waiver of claims by that payee except those previously made in writing and identified by that payee as unsettled at the time of final Application for Payment.

§ 14.1 TERMINATION BY THE CONTRACTOR

§ 14.1.1 The Contractor may terminate the Contract if the Work is stopped for a period of 30 consecutive days through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, for any of the following reasons:

.1 issuance of an order of a court or other public authority having jurisdiction which requires all Work to be stopped;

.2 an act of government, such as a declaration of national emergency which requires all Work to be stopped;

.3 because the Architect has not issued a Certificate for Payment and has not notified the Contractor of the reason for withholding certification as provided in Section 9.4.1, or because the Owner has not made payment on a Certificate for Payment within the time stated in the Contract Documents; or

.4 the Owner has failed to furnish to the Contractor promptly, upon the Contractor's request, reasonable evidence as required by Section 2.2.1.

§ 14.1.2 The Contractor may terminate the Contract if, through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, repeated suspensions, delays or interruptions of the entire Work by the Owner as described in Section 14.3 constitute in the aggregate more than 100 percent of the total number of days scheduled for completion, or 120 days in any 365-day period, whichever is less.

§ 14.1.3 If one of the reasons described in Section 14.1.1 or 14.1.2 exists, the Contractor may, upon seven days' written notice to the Owner and Architect, terminate the Contract and recover from the Owner payment for Work executed and for proven loss with respect to materials, equipment, tools, and construction equipment and machinery, including reasonable overhead, profit and damages.

§ 14.1.4 If the Work is stopped for a period of 60 consecutive days through no act or fault of the Contractor or a Subcontractor or their agents or employees or any other persons performing portions of the Work under contract with the Contractor because the Owner has persistently failed to fulfill the Owner's obligations under the Contract Documents with respect to matters important to the progress of the Work, the Contractor may, upon seven additional days' written notice to the Owner and the Architect, terminate the Contract and recover from the Owner as provided in Section 14.1.3.

§ 13.6 INTEREST

§ 13.6.1 Payments due and unpaid under the Contract Documents shall bear interest from the date payment is due at such rate as the parties may agree upon in writing or, in the absence thereof, at the legal rate prevailing from time to time at the place where the Project is located.

II. CHANGES CLAUSE

Inevitably, changes will occur in the project. Very few, if any, projects are constructed exactly as planned. In addition, very few changes are required that do not involve a request for a change in cost or time. Therefore, the manner in which the Changes Clause requires the parties to handle changes will be important on virtually every project.

The Changes Clause generally allows the Owner to direct a change in the work as long as the change is “within the general scope of the Contract,” without the change

invalidating or breaching the contract. The Clause should also define the requirements for a change order involving a change to the cost or schedule of the project.

a. Cardinal Changes

The question of whether the change is within the general scope of the original contract is a fact specific question. The inquiry generally turns on the question of whether the change is a substantially different undertaking than that originally agreed to between the parties. Changes that materially alter the scope or nature of the work are considered "cardinal" changes and a directive to perform a cardinal change without consent of the contractor performing the changed work would be considered a material breach of the contract. See, *Allied Materials & Equipment Co. v. United States*, 569 F.2d 562 (Ct. Cl. 1978); *Peter Kiewit Son's Co. v. Summit Construction Co.*, 422 F.2d 242 (8th Cir. 1969) (Directive to change construction methods that increased cost by more than 300% exceeded the scope and constituted a breach of the subcontract).

In *Nello Teer Co. v. Jones Brothers*, 641 S.E. 2d 832 (N.C. Ct. App. 2007), the subcontractor estimated that an NCDOT project would require fifteen months. After forty-three months, the subcontractor was still on the job as a result of delays that it alleged were attributable to the owner and the general contractor. The subcontractor claimed that this extended duration excused it from further performance on the project. Although the subcontractor was terminated and therefore its claim for excused performance was never reached, this type of substantial change in the performance criteria is a good example of what may excuse performance.

The Changes Clause also typically provides the methodology for adjusting the contract price for changes in the work. As shown in the AIA form contract, these provisions can be very detailed.

b. Bases for Changing Cost or Time

The standard form contracts each provide for the specific criteria by which the contract sum or time should be adjusted in the event of a change. Obviously, the preferred method is by the agreement of the parties. Each of the standard form contracts explicitly lists three methods for calculating the adjustment through some form of agreement among the parties. These include a mutually acceptable lump sum, mutually acceptable unit prices, or actual costs plus a mutually acceptable fee. Needless to say, each of these methods require a meeting of the minds either at contract inception or through change order negotiation. More important for risk control purposes, however, is the contract's treatment of changes when the parties cannot agree.

With respect to an adjustment to the contract price, each standard contract provides that the adjustment should be made the reasonable actual expense or savings from the change. If there is a net increase in cost, the AIA contract states that the increase to the contract price shall include a reasonable allowance for overhead and profit. There is no provision in the AIA scheme for a decrease in the fee if the change is a net deduction in cost. The AGC contract simply states that if there is an increase, the contractor's fee shall be adjusted accordingly. Unlike the AIA contract, the AGC contract does provide for a decrease in the contractor's fee for a net deduction change order but only if ten percent or more of the original project is deleted.

In other words, absent an agreement on the changed cost, both contracts provide that the adjustment shall be based upon some determination of the "reasonable expenditures and savings."

Both the AIA form contract and the AGC form contract treat changes to the contract affecting project duration in clauses separate from the changes provision. Both contracts have an entire paragraph, with subparagraphs dealing with time related issues. Change Orders involving additional duration, however, will be affected by the interplay of the Changes Clause, the Claims Clause, and the "Time" Clause. Time related changes will be treated separately in this paper under Delays and Extensions of Time.

c. Constructive Changes

Although construction contracts generally allow an owner to direct changes to contract work through either an agreed upon Change Order or a Change Directive, some changes occur without a formal directive or agreement. In this event, a body of law supporting a contractor's equitable right to additional time and/or compensation has been adopted. The most common justification for a constructive change is the Owner's misinterpretation of the contract requirements. In other words, where the Owner holds the contractor to a higher standard than is actually required by the contract specifications. In addition, differing site conditions could justify a constructive change, even in the face of an applicable unit pricing provision. *See, Ray D. Lowder v. North Carolina State Highway Commission*, 26 N.C. App. 622, 217 S.E. 2d 682 (1975) (1,283 percent overrun in the quantity of undercut excavation justified an equitable adjustment in the pre-agreed unit price for this work).

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ARTICLE 7 CHANGES IN THE WORK

§ 7.1 GENERAL

§ 7.1.1 Changes in the Work may be accomplished after execution of the Contract, and without invalidating the Contract, by Change Order, Construction Change Directive or order for a minor change in the Work, subject to the limitations stated in this Article 7 and elsewhere in the Contract Documents.

§ 7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor and Architect; a Construction Change Directive requires agreement by the Owner and Architect and may or may not be agreed to by the Contractor; an order for a minor change in the Work may be issued by the Architect alone.

§ 7.1.3 Changes in the Work shall be performed under applicable provisions of the Contract Documents, and the Contractor shall proceed promptly, unless otherwise provided in the Change Order, Construction Change Directive or order for a minor change in the Work.

§ 7.2 CHANGE ORDERS

§ 7.2.1 A Change Order is a written instrument prepared by the Architect and signed by the Owner, Contractor and Architect, stating their agreement upon all of the following:

- **.1** change in the Work;
- **.2** the amount of the adjustment, if any, in the Contract Sum; and
- **.3** the extent of the adjustment, if any, in the Contract Time.

§ 7.2.2 Methods used in determining adjustments to the Contract Sum may include those listed in Section 7.3.3.

§ 7.3 CONSTRUCTION CHANGE DIRECTIVES

§ 7.3.1 A Construction Change Directive is a written order prepared by the Architect and signed by the Owner and Architect, directing a change in the Work prior to agreement on adjustment, if any, in the Contract Sum or Contract Time, or both. The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, the Contract Sum and Contract Time being adjusted accordingly.

§ 7.3.2 A Construction Change Directive shall be used in the absence of total agreement on the terms of a Change Order.

§ 7.3.3 If the Construction Change Directive provides for an adjustment to the Contract Sum, the adjustment shall be based on one of the following methods:

- **.1** mutual acceptance of a lump sum properly itemized and supported by sufficient substantiating data to permit evaluation;
- **.2** unit prices stated in the Contract Documents or subsequently agreed upon;
- **.3** cost to be determined in a manner agreed upon by the parties and a mutually acceptable fixed or percentage fee; or
- **.4** as provided in Section 7.3.6.

§ 7.3.4 Upon receipt of a Construction Change Directive, the Contractor shall promptly proceed with the change in the Work involved and advise the Architect of the Contractor's agreement or disagreement with the method, if any, provided in the Construction Change Directive for determining the proposed adjustment in the Contract Sum or Contract Time.

§ 7.3.5 A Construction Change Directive signed by the Contractor indicates the agreement of the Contractor therewith, including adjustment in Contract Sum and Contract Time or the method for determining them. Such agreement shall be effective immediately and shall be recorded as a Change Order.

§ 7.3.6 If the Contractor does not respond promptly or disagrees with the method for adjustment in the Contract Sum, the method and the adjustment shall be determined by the Architect on the basis of

reasonable expenditures and savings of those performing the Work attributable to the change, including, in case of an increase in the Contract Sum, a reasonable allowance for overhead and profit. In such case, and also under Section 7.3.3.3, the Contractor shall keep and present, in such form as the Architect may prescribe, an itemized accounting together with appropriate supporting data. Unless otherwise provided in the Contract Documents, costs for the purposes of this Section 7.3.6 shall be limited to the following:

- **.1** costs of labor, including social security, old age and unemployment insurance, fringe benefits required by agreement or custom, and workers' compensation insurance;
- **.2** costs of materials, supplies and equipment, including cost of transportation, whether incorporated or consumed;
- **.3** rental costs of machinery and equipment, exclusive of hand tools, whether rented from the Contractor or others;
- **.4** costs of premiums for all bonds and insurance, permit fees, and sales, use or similar taxes related to the Work; and
- **.5** additional costs of supervision and field office personnel directly attributable to the change.

§ 7.3.7 The amount of credit to be allowed by the Contractor to the Owner for a deletion or change which results in a net decrease in the Contract Sum shall be actual net cost as confirmed by the Architect. When both additions and credits covering related Work or substitutions are involved in a change, the allowance for overhead and profit shall be figured on the basis of net increase, if any, with respect to that change.

§ 7.3.8 Pending final determination of the total cost of a Construction Change Directive to the Owner, amounts not in dispute for such changes in the Work shall be included in Applications for Payment accompanied by a Change Order indicating the parties' agreement with part or all of such costs. For any portion of such cost that remains in dispute, the Architect will make an interim determination for purposes of monthly certification for payment for those costs. That determination of cost shall adjust the Contract Sum on the same basis as a Change Order, subject to the right of either party to disagree and assert a claim in accordance with Article 4.

§ 7.3.9 When the Owner and Contractor agree with the determination made by the Architect concerning the adjustments in the Contract Sum and Contract Time, or otherwise reach agreement upon the adjustments, such agreement shall be effective immediately and shall be recorded by preparation and execution of an appropriate Change Order.

§ 7.4 MINOR CHANGES IN THE WORK

§ 7.4.1 The Architect will have authority to order minor changes in the Work not involving adjustment in the Contract Sum or extension of the Contract Time and not inconsistent with the intent of the Contract Documents. Such changes shall be effected by written order and shall be binding on the Owner and Contractor. The Contractor shall carry out such written orders promptly.

III. CLAIMS CLAUSE

Every construction contract should contain a specific procedure defining and limiting the contractor's ability to advance claims for additional compensation or additional time to complete the project. In particular, a properly crafted Claims Clause should provide specific time limits for the contractor to provide notice to the owner of a potential claim, give a specific time limit for the quantification and justification of the claim, and address limitations, if any, in the type of damages recoverable.

a. Notice

The most important function of the Claims Clause is to establish a time limit on the contractor's right to claim additional compensation or time. The AIA standard contract establishes that limit at 21 days after the claimant first realizes the condition or occurrence giving rise to the claim. The standard AGC provision requires written notice within 14 days after the contractor first recognizes the condition.

Except in the case of an emergency, the contract should also preclude any work that the contractor believes entitles it to a change prior to its delivery of written notice to the owner. Both the AIA standard contract and the AGC standard contract have such restrictions.

b. Basis for Change

We believe that the contract should also clearly define the method or methods for adjusting either the cost or the time or both for performance. In the form contracts, the methodology for adjusting contract price is addressed in the Changes clause and the method for adjusting contract time is addressed in the "Contract Time" paragraphs.

c. Waiver of Consequential Damages

Language in both the AIA and AGC form contracts provide for the mutual waiver by both the contractor and the owner to waive consequential damages. Both provisions include fairly detailed definitions of the consequential damages being waived but the lists are not exclusive.

d. No Damages for Delay

No damages for delay clauses are enforceable in North Carolina. Neither the AIA nor the AGC form contract contains such a provision.

e. Liquidated Damages

Both the AIA form and the AGC form contract explicitly except from their waivers of consequential damages any potential liquidated damages as may be defined elsewhere in the contract. The AGC contract attempts to limit liquidated damages, if any, to those related to direct damages. The AIA form does not make this distinction.

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§ 4.3 CLAIMS AND DISPUTES

§ 4.3.1 Definition. A Claim is a demand or assertion by one of the parties seeking, as a matter of right, adjustment or interpretation of Contract terms, payment of money, extension of time or other relief with respect to the terms of the Contract. The term "Claim" also includes other disputes and matters in question between the Owner and Contractor arising out of or relating to the Contract. Claims must be initiated by written notice. The responsibility to substantiate Claims shall rest with the party making the Claim.

§ 4.3.2 Time Limits on Claims. Claims by either party must be initiated within 21 days after occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later. Claims must be initiated by written notice to the Architect and the other party.

§ 4.3.3 Continuing Contract Performance. Pending final resolution of a Claim except as otherwise agreed in writing or as provided in Section 9.7.1 and Article 14, the Contractor shall proceed diligently with performance of the Contract and the Owner shall continue to make payments in accordance with the Contract Documents.

§ 4.3.4 Claims for Concealed or Unknown Conditions. If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall so notify the Owner and Contractor in writing, stating the reasons. Claims by either party in opposition to such determination must be made within 21 days after the Architect has given notice of the decision. If the conditions encountered are materially different, the Contract Sum and Contract Time shall be equitably adjusted, but if the Owner and Contractor cannot agree on an adjustment in the Contract Sum or Contract Time, the adjustment shall be referred to the Architect for initial determination, subject to further proceedings pursuant to Section 4.4.

§ 4.3.5 Claims for Additional Cost. If the Contractor wishes to make Claim for an increase in the Contract Sum, written notice as provided herein shall be given before proceeding to execute the Work. Prior notice is not required for Claims relating to an emergency endangering life or property arising under Section 10.6.

§ 4.3.6 If the Contractor believes additional cost is involved for reasons including but not limited to (1) a written interpretation from the Architect, (2) an order by the Owner to stop the Work where the Contractor

was not at fault, (3) a written order for a minor change in the Work issued by the Architect, (4) failure of payment by the Owner, (5) termination of the Contract by the Owner, (6) Owner's suspension or (7) other reasonable grounds, Claim shall be filed in accordance with this Section 4.3.

§ 4.3.7 Claims for Additional Time
§ 4.3.7.1 If the Contractor wishes to make Claim for an increase in the Contract Time, written notice as provided herein shall be given. The Contractor's Claim shall include an estimate of cost and of probable effect of delay on progress of the Work. In the case of a continuing delay only one Claim is necessary.

§ 4.3.7.2 If adverse weather conditions are the basis for a Claim for additional time, such Claim shall be documented by data substantiating that weather conditions were abnormal for the period of time, could not have been reasonably anticipated and had an adverse effect on the scheduled construction.

§ 4.3.8 Injury or Damage to Person or Property. If either party to the Contract suffers injury or damage to person or property because of an act or omission of the other party, or of others for whose acts such party is legally responsible, written notice of such injury or damage, whether or not insured, shall be given to the other party within a reasonable time not exceeding 21 days after discovery. The notice shall provide sufficient detail to enable the other party to investigate the matter.

§ 4.3.9 If unit prices are stated in the Contract Documents or subsequently agreed upon, and if quantities originally contemplated are materially changed in a proposed Change Order or Construction Change Directive so that application of such unit prices to quantities of Work proposed will cause substantial inequity to the Owner or Contractor, the applicable unit prices shall be equitably adjusted.

§ 4.3.10 Claims for Consequential Damages. The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes:

- **.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.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Section 4.3.10 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

IV. DISPUTE RESOLUTION

A detailed analysis of alternative dispute resolution provisions is contained in a separate paper.

§ 4.4 RESOLUTION OF CLAIMS AND DISPUTES

§ 4.4.1 Decision of Architect. Claims, including those alleging an error or omission by the Architect but excluding those arising under Sections 10.3 through 10.5, shall be referred initially to the Architect for decision. An initial decision by the Architect shall be required as a condition precedent to mediation, arbitration or litigation of all Claims between the Contractor and Owner arising prior to the date final payment is due, unless 30 days have passed after the Claim has been referred to the Architect with no decision having been rendered by the Architect. The Architect will not decide disputes between the Contractor and persons or entities other than the Owner.

§ 4.4.2 The Architect will review Claims and within ten days of the receipt of the Claim take one or more of the following actions: (1) request additional supporting data from the claimant or a response with supporting data from the other party, (2) reject the Claim in whole or in part, (3) approve the Claim, (4) suggest a compromise, or (5) advise the parties that the Architect is unable to resolve the Claim if the Architect lacks sufficient information to evaluate the merits of the Claim or if the Architect concludes that, in the Architect's sole discretion, it would be inappropriate for the Architect to resolve the Claim.

§ 4.4.3 In evaluating Claims, the Architect may, but shall not be obligated to, consult with or seek information from either party or from persons with special knowledge or expertise who may assist the Architect in rendering a decision. The Architect may request the Owner to authorize retention of such persons at the Owner's expense.

§ 4.4.4 If the Architect requests a party to provide a response to a Claim or to furnish additional supporting data, such party shall respond, within ten days after receipt of such request, and shall either provide a response on the requested supporting data, advise the Architect when the response or supporting data will be furnished or advise the Architect that no supporting data will be furnished. Upon receipt of the response or supporting data, if any, the Architect will either reject or approve the Claim in whole or in part.

§ 4.4.5 The Architect will approve or reject Claims by written decision, which shall state the reasons therefor and which shall notify the parties of any change in the Contract Sum or Contract Time or both. The approval or rejection of a Claim by the Architect shall be final and binding on the parties but subject to mediation and arbitration.

§ 4.4.6 When a written decision of the Architect states that (1) the decision is final but subject to mediation and arbitration and (2) a demand for arbitration of a Claim covered by such decision must be made within 30 days after the date on which the party making the demand receives the final written decision, then failure to demand arbitration within said 30 days' period shall result in the Architect's decision becoming final and binding upon the Owner and Contractor. If the Architect renders a decision after arbitration proceedings have been initiated, such decision may be entered as evidence, but shall not supersede arbitration proceedings unless the decision is acceptable to all parties concerned.

§ 4.4.7 Upon receipt of a Claim against the Contractor or at any time thereafter, the Architect or the Owner may, but is not obligated to, notify the surety, if any, of the nature and amount of the Claim. If the Claim relates to a possibility of a Contractor's default, the Architect or the Owner may, but is not obligated to, notify the surety and request the surety's assistance in resolving the controversy.

§ 4.4.8 If a Claim relates to or is the subject of a mechanic's lien, the party asserting such Claim may proceed in accordance with applicable law to comply with the lien notice or filing deadlines prior to resolution of the Claim by the Architect, by mediation or by arbitration.

§ 4.5 MEDIATION

§ 4.5.1 Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect and except those waived as provided for in Sections 4.3.10, 9.10.4 and 9.10.5 shall, after initial decision by the Architect or 30 days after submission of the Claim to the Architect, be subject to mediation as a condition precedent to arbitration or the institution of legal or equitable proceedings by either party.

§ 4.5.2 The parties shall endeavor to resolve their Claims by mediation which, unless the parties mutually agree otherwise, shall be in accordance with the Construction Industry Mediation Rules of the American Arbitration Association currently in effect. Request for mediation shall be filed in writing with the other party to the Contract and with the American Arbitration Association. The request may be made concurrently with the filing of a demand for arbitration but, in such event, mediation shall proceed in advance of arbitration or legal or equitable proceedings, which shall be stayed pending mediation for a period of 60 days from the date of filing, unless stayed for a longer period by agreement of the parties or court order.

§ 4.5.3 The parties shall share the mediator's fee and any filing fees equally. The mediation shall be held in the place where the Project is located, unless another location is mutually agreed upon. Agreements reached in mediation shall be enforceable as settlement agreements in any court having jurisdiction thereof.

§ 4.6 ARBITRATION

§ 4.6.1 Any Claim arising out of or related to the Contract, except Claims relating to aesthetic effect and except those waived as provided for in Sections 4.3.10, 9.10.4 and 9.10.5, shall, after decision by the Architect or 30 days after submission of the Claim to the Architect, be subject to arbitration. Prior to arbitration, the parties shall endeavor to resolve disputes by mediation in accordance with the provisions of Section 4.5.

§ 4.6.2 Claims not resolved by mediation shall be decided by arbitration which, unless the parties mutually agree otherwise, shall be in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association currently in effect. The demand for arbitration shall be filed in writing with the other party to the Contract and with the American Arbitration Association, and a copy shall be filed with the Architect.

§ 4.6.3 A demand for arbitration shall be made within the time limits specified in Sections 4.4.6 and 4.6.1 as applicable, and in other cases within a reasonable time after the Claim has arisen, and in no event shall it be made after the date when institution of legal or equitable proceedings based on such Claim would be barred by the applicable statute of limitations as determined pursuant to Section 13.7.

§ 4.6.4 Limitation on Consolidation or Joinder. No arbitration arising out of or relating to the Contract shall include, by consolidation or joinder or in any other manner, the Architect, the Architect's employees or consultants, except by written consent containing specific reference to the Agreement and signed by the Architect, Owner, Contractor and any other person or entity sought to be joined. No arbitration shall include, by consolidation or joinder or in any other manner, parties other than the Owner, Contractor, a separate contractor as described in Article 6 and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration. No person or entity other than the Owner, Contractor or a separate contractor as described in Article 6 shall be included as an original third party or additional third party to an arbitration whose interest or responsibility is insubstantial. Consent to arbitration involving an additional person or entity shall not constitute consent to arbitration of a Claim not described therein or with a person or entity not named or described therein. The foregoing agreement to arbitrate and other agreements to arbitrate with an additional person or entity duly consented to by parties to the Agreement shall be specifically enforceable under applicable law in any court having jurisdiction thereof.

§ 4.6.5 Claims and Timely Assertion of Claims. The party filing a notice of demand for arbitration must assert in the demand all Claims then known to that party on which arbitration is permitted to be demanded.

§ 4.6.6 Judgment on Final Award. The award rendered by the arbitrator or arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof.

V. ACCELERATION AND DELAY

Timely completion of a construction project is critical to the financial success of the project from the perspective of both the owner and the contractor. Delayed performance will cost the owner revenue and/or additional cost related to inability to occupy the property. Likewise, the contractor will incur additional costs for jobsite and

home office overhead and may have to forego lucrative other opportunities as a result of extended performance. Some or all of these costs may be waived in the contract. In some cases, the cost of delay is set in the form of liquidated damages. In any event, extended performance will almost certainly result in a claim for additional time and may result in a claim for additional compensation.

Every construction contract should describe the types of delays that will entitle a contractor to an extension of the performance period and the types of delays that will justify additional compensation. In general, events or occurrences that delay a project are either excusable or nonexcusable. Some, but not all, excusable delay is also compensable.

A contractor's obligation to perform within the project time is generally not excused if the delaying event or occurrence was either reasonably foreseeable or within the contractor's control. Delays caused by unforeseen causes that are not within the control of either party are usually excusable delays but not compensable. In other words, the contractor is entitled to an extension of time to complete performance but not to additional compensation. Compensable delays are also excusable but because they are caused by something within the control of the owner the contractor is entitled to both an extension of time and additional compensation.

The standard form contracts treat time related claims in a separate section from "Claims" or "Change Orders." Instead, both treat these claims in a separate section entitled "Time" or "Contract Time." However, in spite of this treatment, there are other contract provisions that will impact a delay claim. The contract's scheduling

requirements will impact the parties' ability to identify the cause of delays and/or to allocate the delays to a variety of causes and culprits.

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§ 8.3 DELAYS AND EXTENSIONS OF TIME
§ 8.3.1 If the Contractor is delayed at any time in the commencement or progress of the Work by an act or neglect of the Owner or Architect, or of an employee of either, or of a separate contractor employed by the Owner, or by changes ordered in the Work, or by labor disputes, fire, unusual delay in deliveries, unavoidable casualties or other causes beyond the Contractor's control, or by delay authorized by the Owner pending mediation and arbitration, or by other causes which the Architect determines may justify delay, then the Contract Time shall be extended by Change Order for such reasonable time as the Architect may determine.

§ 8.3.2 Claims relating to time shall be made in accordance with applicable provisions of Section 4.3.

§ 8.3.3 This Section 8.3 does not preclude recovery of damages for delay by either party under other provisions of the Contract Documents.

§ 4.3.7 Claims for Additional Time
§ 4.3.7.1 If the Contractor wishes to make Claim for an increase in the Contract Time, written notice as provided herein shall be given. The Contractor's Claim shall include an estimate of cost and of probable effect of delay on progress of the Work. In the case of a continuing delay only one Claim is necessary.

§ 4.3.7.2 If adverse weather conditions are the basis for a Claim for additional time, such Claim shall be documented by data substantiating that weather conditions were abnormal for the period of time, could not have been reasonably anticipated and had an adverse effect on the scheduled construction.

VI. SCHEDULING CLAUSE

The scheduling requirements for a complex construction project are arguably the most important provisions in the contract not only because of their importance in the resolution of claims but also because of their importance to the management of the project and avoidance of time-related claims. Where the project requires appropriate scheduling and the contractor manages the project to an appropriate schedule many of the potential problems with potential delays can be eliminated or at least minimized. Because of the importance of scheduling and its relationship to delay and/or acceleration claims, this topic is treated in more detail separately.

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§ 3.10 CONTRACTOR'S CONSTRUCTION SCHEDULES
§ 3.10.1 The Contractor, promptly after being awarded the Contract, shall prepare and submit for the Owner's and Architect's information a Contractor's construction schedule for the Work. The schedule shall

not exceed time limits current under the Contract Documents, shall be revised at appropriate intervals as required by the conditions of the Work and Project, shall be related to the entire Project to the extent required by the Contract Documents, and shall provide for expeditious and practicable execution of the Work.

§ 3.10.2 The Contractor shall prepare and keep current, for the Architect's approval, a schedule of submittals which is coordinated with the Contractor's construction schedule and allows the Architect reasonable time to review submittals.

§ 3.10.3 The Contractor shall perform the Work in general accordance with the most recent schedules submitted to the Owner and Architect.

EXAMPLE OF MORE DETAILED REQUIREMENTS

§ 3.10 CONTRACTOR'S CONSTRUCTION SCHEDULES

§ 3.10.1 The Contractor, promptly after being awarded the Contract, but in no event more than thirty (30) days after the Notice to Proceed, shall prepare and submit for the Owner's and Architect's approval a Contractor's Construction Schedule ("CPM Schedule") for each Subproject included in the Work. Each such schedule shall not exceed time limits current under the Contract Documents, shall be revised at appropriate intervals as required by the conditions of the Work and Subproject, shall be related to the entire Project to the extent required by the Contract Documents, and shall provide for expeditious and practicable execution of the Work. The approval of any CPM Schedule by the Owner or Architect shall not relieve the Contractor of its sole responsibility to complete the Project and all Subprojects within the Contract Time.

- **.1** The CPM Schedule shall be a critical path method ("CPM") schedule created and maintained on an accepted standard computer program.
- **.2** The CPM Schedule to be prepared and submitted to the Owner and the Architect shall consist of a CPM network (diagram of activities) and a computer-generated print out as specified herein. The format shall be the activity on node precedence network.
- **.3** The network shall show the order and inter-dependence of activities and the sequence in which the work is to be accomplished. At a minimum the network diagram must demonstrate how the start of a given activity is dependent on the completion of preceding activities and how its completion restricts the start of following activities.
- **.4** The network will separately identify all construction activities with durations in excess of ten (10) days and the submittal and approval of all materials and shop drawings, the procurement of equipment and materials.
- **.5** The CPM schedule shall include tasks and activities that are the responsibility of the Architect or the Owner. The Contractor shall promptly notify the Architect and the Owner if a delay in any such task or activity will delay construction.
- **.6** All activities shall be grouped by sub-project.
- **.7** The CPM schedule may be created and maintained by the Contractor or an independent scheduler. The Contractor shall identify the individual or entity primarily responsible for creating and maintaining the schedule and provide the Owner with a description of the scheduler's qualifications. The Contractor shall not use a scheduler without the approval of the Owner. Approval of the scheduler shall not be unreasonably withheld.

§ 3.10.2 The CPM Schedule shall contain milestone or completion dates consistent with the Contract requirements and shall clearly identify the critical path.

- **.1** The milestone and completion dates indicated are considered essential to the timely completion of the Work, the satisfactory performance under this Contract and for the coordination of all Work on the Project. The milestone dates listed are not intended to be a complete listing of all Work under this Contract or of all interfaces with other Project contractors.
- **.2** The milestone dates listed represent the latest allowable completion dates. Earlier milestones completion dates, including the contractual completion date for the Project, may be established by the Contractor in the baseline schedule, but the Owner and Architect shall not be liable to the Contractor or any Subcontractors for any costs or other damages should the

Contractor or any Subcontractors be unable to complete the Work before such early milestone or completion dates regardless of cause.

.3 The duties, obligations and warranties of the Owner to the Contractor shall be consistent with and applicable only to the completion of the Work on the milestone and completion dates required in the Contract Documents, unless such earlier dates are agreed to by Change Order.

.4 The Owner shall give the Contractor a written notice to proceed stating the date on which Work is to commence, said date to be at least seven days after the notice. This notice shall also state the date of substantial completion. After acceptance of each guaranteed maximum price and authorization to the Contractor for construction of an individual Project and within fifteen (15) days of written notice to proceed, the Contractor shall submit a preliminary CPM schedule for inclusion in the Subcontractor bid packages consistent with the timeframes for each Project.

.5 Within thirty (30) days of the notice to proceed, the Contractor shall obtain from the Subcontractors their respective Work activities and integrate them into a Project construction schedule. The Contractor shall develop a complete CPM schedule in the form of a CPM network arrow diagram using the Contractor's logic and time estimates for each segment of the Work and shall be cost loaded, the sum of which totals the guaranteed maximum price exclusive of a construction contingency, and manpower loaded to complete the Work within the scheduled time frames. The scheduling obligation shall include tracking the progress of the Owner's and Architect's tasks and activities in relation to the milestone schedule and promptly notifying Owner of any delay that might impact construction. The Contractor shall make recommendations to the Owner, with a copy to the Architect, regarding strategies for overcoming any delay in the design of the Project that will affect the construction schedule. The Contractor and the Architect shall prepare, if deemed necessary, a schedule fixing dates upon which foreseeable clarifications will be required. The schedule will be subject to addition or change in accordance with progress of the Work. The Architect shall furnish drawings or clarifications in accordance with that schedule. The Contractor shall not proceed with the Work without such detail drawings and/or written clarifications.

.6 The arrow network diagram will be drawn in a level of detail suitable for display of salient features of the Work, including but not limited to the placing of orders for materials, submission of shop drawings for approval, approval of shop drawings by the Architect and the Owner, delivery of material, and all Work activities including the punch list agreed to by the Owner. Each Work activity shall be assigned a time estimate by the Contractor. One-day shall be the smallest time unit used. Data shall also be provided in Gantt form. This cost loaded schedule will not be the basis for invoicing, but may be considered by the Architect and the Owner when evaluating the percentage of Work represented to be complete in each schedule of values.

.7 Upon completion of the network diagrams, the Contractor shall have computer input data prepared, and a computer run made to generate a printout for the Project based on the information supplied. In the event the completion date indicated by the schedule exceeds the substantial completion date, the logic and time estimates used to develop the plan will be reviewed, changes made in the logic and time estimates, and another computer run made to generate a new schedule. This procedure shall be repeated, if necessary, to provide a plan and schedule to meet Owner requirements. All submissions shall be both in hard copy and in electronic format.

.8 Within fifteen (15) days of the notice to proceed, the updated CPM schedule shall be submitted to the Owner for review and approval. No application for payment will be processed until the Project CPM schedule is approved by the Owner. This working plan shall show job identification, job duration, manpower loading, cost loading, calendar dates for start and finish of each job, and jobs critical to the completion of the Project on schedule. When approved by the Owner, this information shall become the working plan and schedule for the Project and such information shall be provided to the Contractor for distribution. The Contractor shall distribute to the Subcontractors the approved Project CPM schedule and shall display same at the job site.

.9 The Contractor shall review the plan and schedule each week. An updated cost-loaded Project schedule shall be furnished showing actual completed Work at the end of each month in respect to the entire Project. The form used shall be approved by the Owner and shall be submitted with the monthly invoice. The Contractor shall also develop and submit a Work plan for a two week, thirty day and sixty day look ahead.

.10 The Contractor must also submit with each Application for Payment a computer-generated list of all changes to the activities, their duration, and logic from the previous schedule.

.11 The Contractor shall provide regular monitoring of the schedule as construction progresses, identify potential variances between scheduled and desired completion dates, review the schedule for Work not started or incomplete, review the status of submittals and delivery of long-lead time deliveries, review the Owner's occupancy priorities, and take the action necessary to meet the required completion date. The Contractor shall furnish to the Owner various schedules and updates setting forth planned and completed progress of the Project broken down by the various divisions or parts of the Work and by calendar days. The Contractor shall ensure that all schedules are prepared and updated in strict conformance with the Owner's requirements for formatting of reports for the Owner. The Contractor shall keep the Owner, the Architect and all Subcontractors fully informed as to all changes and updates to the schedule. The Contractor shall ensure that all schedules are prepared and updated in strict conformance with the Owner's requirements and for provision of one inclusive schedule incorporating necessary lead times for actions required, by the Owner and regulatory agencies, by the Contractor, and by utility companies providing services or locating service lines and facilities, by all Subcontractors, and for significant general conditions' activities, including but not limited to agenda submittals, permit and approvals applications and review of interim and final plans, specifications and bid packages.

.12 The Contractor shall provide regular monitoring of the schedule as construction progresses, identify potential variances between scheduled and desired completion dates, review the schedule for Work not started or incomplete, review the status of submittals and delivery of long-lead time deliveries, review the Owner's occupancy priorities, and take the action necessary to meet the required completion date. The Contractor shall furnish to the Owner various schedules and updates setting forth planned and completed progress of the Project broken down by the various divisions or parts of the Work and by calendar days. The Contractor shall ensure that all schedules are prepared and updated in strict conformance with the Owner's requirements for formatting of reports for the Owner. The Contractor shall keep the Owner, the Architect and all Subcontractors fully informed as to all changes and updates to the schedule. The Contractor shall ensure that all schedules are prepared and updated in strict conformance with the Owner's requirements and for provision of one inclusive schedule incorporating necessary lead times for actions required, by the Owner and regulatory agencies, by the Contractor, and by utility companies providing services or locating service lines and facilities, by all Subcontractors, and for significant general conditions' activities, including but not limited to agenda submittals, permit and approvals applications and review of interim and final plans, specifications and bid packages.

.13 The Contractor shall submit to the Architect a written monthly report of the status of all Work activities. The monthly status report shall show the actual Work completed to date in comparison with the original amount of Work scheduled. If the Work is behind schedule, the Contractor must indicate in writing what measures are being taken to bring the Work back on schedule and ensure that the Contract completion date is not exceeded. If the Work is greater then fourteen (14) days behind schedule, then the Contractor shall prepare and submit to the Architect a recovery schedule for review and approval.

.14 The schedule and all updates to the schedule shall represent a practical plan to complete the Work by the date of substantial completion. Extension of any schedule shall not be acceptable. Schedules showing the Work completed in less than the contract time may be acceptable if judged by Architect and Owner's Representative to be practical. However, acceptance of such a schedule shall not change the date of substantial completion or constitute acceleration resulting in any additional costs to the Owner for the Work, general conditions or fees. The date of substantial completion, not the contract schedule, shall

control in the determination of liquidated damages payable by Contractor and in the determination of any delay.

.15 Architect or Owner's Representative's acceptance of or its review comments about any schedule or scheduling data shall not relieve Contractor from its sole responsibility to plan for, perform, and complete the Work within the contract time. Acceptance of or review comments about any schedule shall not transfer responsibility for any schedule to the Owner nor imply their agreement with (1) any assumption upon which such schedule is based or (2) any matter underlying or contained in such schedule.

.16 Failure of Architect or Owner's Representative to discover errors or omissions in schedules that it has reviewed, or to inform Contractor that Contractor, Subcontractors, or others are behind schedule, or to direct or enforce procedures for complying with the schedule shall not relieve Contractor from its sole responsibility to perform and complete the Work on time and shall not be a cause for an adjustment of the contract time or the Guaranteed Maximum Price.

.17 Contractor shall perform the Work in accordance with the current accepted schedule.

.18 The Work shall start upon the date given in the notice to proceed. The Contractor shall complete all the Work necessary, including but not limited to substantial completion, close-out, testing and demonstration of all systems as required for acceptance, punchlists, training and submission of record documents, manuals, guarantees and warranties.

.19 Time is of the essence with respect to the Work. By executing the Construction Manager At Risk Contract, the Contractor confirms and agrees that the days for substantial completion are reasonable period to perform the Work. The Contractor shall proceed expeditiously with adequate forces and shall achieve substantial completion on time. The Contractor may, at its discretion, plan to complete the work and achieve substantial completion in less time.

§ 3.10.3 The Contractor shall monitor and update the CPM Schedule as construction progresses and submit a copy of the approved CPM Schedule updated by actual progress in activities with each Application for Payment.

.1 The CPM Schedule submitted with each Application for Payment should accurately reflect the progress of the work up through and including two (2) business days prior to the date of the Application for Payment.

§ 3.10.4 The CPM Schedule shall allow for the integration of all aspects of the Project and provide for the coordination of all Work.

§ 3.10.5 The Contractor shall prepare and keep current, for the Architect's approval, a schedule of submittals which is coordinated with the Contractor's construction schedule and allows the Architect reasonable time to review submittals.

§ 3.10.6 The Contractor shall perform the Work in general accordance with the most recent schedules submitted to the Owner and Architect.

VII. DIFFERING SITE CONDITIONS

The Changed Conditions clause is designed to allocate the risk that there are conditions related to the project site that will affect the viability, cost, or schedule of a project. Differing site conditions include not only subsurface soils conditions but can also include hidden or unknown conditions of pre-existing structures on the property. Although North Carolina law is silent on the issue, it is generally accepted that absent

misrepresentation by the owner or contractual provisions to the contrary, the contractor assumes the risk of unanticipated site conditions.

The form contracts, including AIA A201, provide for the risk to be borne by the owner if the conditions are: (1) subsurface or otherwise concealed or (2) unknown and of an unusual nature. The reasons for this risk shifting provision is to eliminate the need for a contractor to include additional costs in its contract, either for a thorough investigation of the conditions or for a contingency against unanticipated conditions. Where the burden is on the owner and there is a mechanism for compensating the contractor for differing conditions, the contractor's price will be lower.

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§ 1.5.2 Execution of the Contract by the Contractor is a representation that the Contractor has visited the site, become generally familiar with local conditions under which the Work is to be performed and correlated personal observations with requirements of the Contract Documents.

§ 2.2.3 The Owner shall furnish surveys describing physical characteristics, legal limitations and utility locations for the site of the Project, and a legal description of the site. The Contractor shall be entitled to rely on the accuracy of information furnished by the Owner but shall exercise proper precautions relating to the safe performance of the Work.

§ 4.3.4 Claims for Concealed or Unknown Conditions. If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall so notify the Owner and Contractor in writing, stating the reasons. Claims by either party in opposition to such determination must be made within 21 days after the Architect has given notice of the decision. If the conditions encountered are materially different, the Contract Sum and Contract Time shall be equitably adjusted, but if the Owner and Contractor cannot agree on an adjustment in the Contract Sum or Contract Time, the adjustment shall be referred to the Architect for initial determination, subject to further proceedings pursuant to Section 4.4.

VIII. WARRANTIES

The quality warranty should require the contractor to warrant that the materials and equipment used on the project are of a good and workmanlike quality, that the work

is free from defects, and that the work meets the specifications in every respect. If the warranty calls for the contract work to meet certain other standards, it may effectively convert the specifications into performance specifications, which as we have seen carries more risk for the contractor.

In addition, the contract should require the contractor to return to the site and promptly correct any defective work or work that is found not to be in conformance with the contract documents. This remedy, however, should not be exclusive. In other words, the contract should not limit the owner's rights to calling the contractor back to the project if the work does not meet the warranty.

§ 3.5 WARRANTY

§ 3.5.1 The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless otherwise required or permitted by the Contract Documents, that the Work will be free from defects not inherent in the quality required or permitted, and that the Work will conform to the requirements of the Contract Documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

§ 12.2 CORRECTION OF WORK

§ 12.2.1 BEFORE OR AFTER SUBSTANTIAL COMPLETION

§ 12.2.1.1 The Contractor shall promptly correct Work rejected by the Architect or failing to conform to the requirements of the Contract Documents, whether discovered before or after Substantial Completion and whether or not fabricated, installed or completed. Costs of correcting such rejected Work, including additional testing and inspections and compensation for the Architect's services and expenses made necessary thereby, shall be at the Contractor's expense.

§ 12.2.2 AFTER SUBSTANTIAL COMPLETION

§ 12.2.2.1 In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1, or by terms of an applicable special warranty required by the Contract Documents, any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.

§ 12.2.2.2 The one-year period for correction of Work shall be extended with respect to portions of Work first performed after Substantial Completion by the period of time between Substantial Completion and the actual performance of the Work.

§ 12.2.2.3 The one-year period for correction of Work shall not be extended by corrective Work performed by the Contractor pursuant to this Section 12.2.

§ 12.2.3 The Contractor shall remove from the site portions of the Work which are not in accordance with the requirements of the Contract Documents and are neither corrected by the Contractor nor accepted by the Owner.

§ 12.2.4 The Contractor shall bear the cost of correcting destroyed or damaged construction, whether completed or partially completed, of the Owner or separate contractors caused by the Contractor's correction or removal of Work which is not in accordance with the requirements of the Contract Documents.

§ 12.2.5 Nothing contained in this Section 12.2 shall be construed to establish a period of limitation with respect to other obligations which the Contractor might have under the Contract Documents. Establishment of the one-year period for correction of Work as described in Section 12.2.2 relates only to the specific obligation of the Contractor to correct the Work, and has no relationship to the time within which the obligation to comply with the Contract Documents may be sought to be enforced, nor to the time within which proceedings may be commenced to establish the Contractor's liability with respect to the Contractor's obligations other than specifically to correct the Work.

IX. CLAUSES RELATED TO SUBCONTRACTOR CLAIMS

a. Flow Down Provisions

As we have seen, one of the most important contract clauses involves the scope of the work to be performed. Because the actual construction on most complex construction projects is not performed by one of the parties to the general contract, it is of paramount importance to the general contractor to ensure that the scope of the work of its various subcontracts is consistent with the scope it agreed to perform for the owner. In order to ensure this, it is important to define the contract documents consistently in both the general contract and to explicitly incorporate the general contract's requirements into the subcontracts.

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§ 1.1.1 THE CONTRACT DOCUMENTS

The Contract Documents consist of the Agreement between Owner and Contractor (hereinafter the Agreement), Conditions of the Contract (General, Supplementary and other Conditions), Drawings, Specifications, Addenda issued prior to execution of the Contract, other documents listed in the Agreement and Modifications issued after execution of the Contract. A Modification is (1) a written amendment to the Contract signed by both parties, (2) a Change Order, (3) a Construction Change Directive or (4) a written order for a minor change in the Work issued by the Architect. Unless specifically enumerated in the

Agreement, the Contract Documents do not include other documents such as bidding requirements (advertisement or invitation to bid, Instructions to Bidders, sample forms, the Contractor's bid or portions of Addenda relating to bidding requirements).

§ 3.12.4 Shop Drawings, Product Data, Samples and similar submittals are not Contract Documents. The purpose of their submittal is to demonstrate for those portions of the Work for which submittals are required by the Contract Documents the way by which the Contractor proposes to conform to the information given and the design concept expressed in the Contract Documents. Review by the Architect is subject to the limitations of Section 4.2.7. Informational submittals upon which the Architect is not expected to take responsive action may be so identified in the Contract Documents. Submittals which are not required by the Contract Documents may be returned by the Architect without action.

§ 5.3 SUBCONTRACTUAL RELATIONS

§ 5.3.1 By appropriate agreement, written where legally required for validity, the Contractor shall require each Subcontractor, to the extent of the Work to be performed by the Subcontractor, to be bound to the Contractor by terms of the Contract Documents, and to assume toward the Contractor all the obligations and responsibilities, including the responsibility for safety of the Subcontractor's Work, which the Contractor, by these Documents, assumes toward the Owner and Architect. Each subcontract agreement shall preserve and protect the rights of the Owner and Architect under the Contract Documents with respect to the Work to be performed by the Subcontractor so that subcontracting thereof will not prejudice such rights, and shall allow to the Subcontractor, unless specifically provided otherwise in the subcontract agreement, the benefit of all rights, remedies and redress against the Contractor that the Contractor, by the Contract Documents, has against the Owner. Where appropriate, the Contractor shall require each Subcontractor to enter into similar agreements with Sub-subcontractors. The Contractor shall make available to each proposed Subcontractor, prior to the execution of the subcontract agreement, copies of the Contract Documents to which the Subcontractor will be bound, and, upon written request of the Subcontractor, identify to the Subcontractor terms and conditions of the proposed subcontract agreement which may be at variance with the Contract Documents. Subcontractors will similarly make copies of applicable portions of such documents available to their respective proposed Sub-subcontractors.

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§ 1.1 The Subcontract Documents consist of (1) this Agreement; (2) the Prime Contract, consisting of the Agreement between the Owner and Contractor and the other Contract Documents enumerated therein; (3) Modifications issued subsequent to the execution of the Agreement between the Owner and Contractor, whether before or after the execution of this Agreement; (4) other documents listed in Article 16 of this Agreement; and (5) Modifications to this Subcontract issued after execution of this Agreement. These form the Subcontract, and are as fully a part of the Subcontract as if attached to this Agreement or repeated herein. The Subcontract represents the entire and integrated agreement between the parties hereto and supersedes prior negotiations, representations or agreements, either written or oral. An enumeration of the Subcontract Documents, other than Modifications issued subsequent to the execution of this Agreement, appears in Article 16.

§ 2.1 The Contractor and Subcontractor shall be mutually bound by the terms of this Agreement and, to the extent that the provisions of the edition of AIA Document A201 current as of the date of this Agreement apply to this Agreement pursuant to Section 1.2 and provisions of the Prime Contract apply to the Work of the Subcontractor, the Contractor shall assume toward the Subcontractor all obligations and responsibilities that the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities which the Contractor, under such documents, assumes toward the Owner and the Architect. The Contractor shall have the benefit of all rights, remedies and redress against the Subcontractor which the Owner, under such documents, has against the Contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor which the Contractor, under such documents, has against the Owner, insofar as applicable to this Subcontract. Where a provision of such documents is inconsistent with a provision of this Agreement, this Agreement shall govern.

b. Liens

Every construction contract should require the general contractor to take immediate steps to remove any lien on the property placed by a subcontractor or supplier. However, neither the AIA form contract nor the AGC form contract include this requirement. North Carolina lien law is covered in more detail elsewhere in this paper.

LIENS

§ 2.1.2 The Owner shall furnish to the Contractor within fifteen days after receipt of a written request, information necessary and relevant for the Contractor to evaluate, give notice of or enforce mechanic's lien rights. Such information shall include a correct statement of the record legal title to the property on which the Project is located, usually referred to as the site, and the Owner's interest therein.

§ 4.4.8 If a Claim relates to or is the subject of a mechanic's lien, the party asserting such Claim may proceed in accordance with applicable law to comply with the lien notice or filing deadlines prior to resolution of the Claim by the Architect, by mediation or by arbitration.

§ 9.3.3 The Contractor warrants that title to all Work covered by an Application for Payment will pass to the Owner no later than the time of payment. The Contractor further warrants that upon submittal of an Application for Payment all Work for which Certificates for Payment have been previously issued and payments received from the Owner shall, to the best of the Contractor's knowledge, information and belief, be free and clear of liens, claims, security interests or encumbrances in favor of the Contractor, Subcontractors, material suppliers, or other persons or entities making a claim by reason of having provided labor, materials and equipment relating to the Work.

§ 9.10.4 The making of final payment shall constitute a waiver of Claims by the Owner except those arising from:

.1 liens, Claims, security interests or encumbrances arising out of the Contract and unsettled;
.2 failure of the Work to comply with the requirements of the Contract Documents; or
.3 terms of special warranties required by the Contract Documents.

§ 9.10.5 Acceptance of final payment by the Contractor, a Subcontractor or material supplier shall constitute a waiver of claims by that payee except those previously made in writing and identified by that payee as unsettled at the time of final Application for Payment.

c. Indemnification

Contractual provisions that purport to shift responsibility for personal injuries occurring in connection with the improvement of real property are against public policy in North Carolina and, therefore, unenforceable.

§ 3.18 INDEMNIFICATION

§ 3.18.1 To the fullest extent permitted by law and to the extent claims, damages, losses or expenses are not covered by Project Management Protective Liability insurance purchased by the Contractor in accordance with Section 11.3, the Contractor shall indemnify 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. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this Section 3.18.

§ 3.18.2 In claims against any person or entity indemnified under this Section 3.18 by an employee of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, the indemnification obligation under Section 3.18.1 shall not be limited by a limitation on amount or type of damages, compensation or benefits payable by or for the Contractor or a Subcontractor under workers' compensation acts, disability benefit acts or other employee benefit acts.

X. TERMINATION

a. Termination by the Contractor

A balanced contract should give the contractor the right to terminate the contract, even in the absence of a material breach by the owner, but only under specifically defined circumstances. These circumstances usually include a lengthy suspension of performance and the unwarranted or improper withholding of payment. The contractor's right is a corollary to the owner's right to suspend construction without terminating it. It would be patently unfair to allow the owner to suspend performance indefinitely and expect the contractor to re-commence performance under the terms of the original contract.

b. Termination by the Owner for Convenience

Every construction contract should provide for the owner's right to terminate the contract without cause. The owner may need to terminate the contract for any number of reasons that have nothing to do with a default on the part of the contractor. The question of risk allocation in this provision is related to what, if any, remedy the contractor may have in the event of a termination for convenience.

In the event of a termination for convenience, it should go without saying that the contractor is entitled to recover the costs that it has expended together with any costs of de-mobilization. The contractor should also be entitled to recover the costs for materials and equipment rental for which it has committed itself, at least to the extent they cannot be applied elsewhere. The question is whether the contractor should be entitled to recover the profit and overhead that it would have earned if it had been allowed to complete the project.

The AIA form contract takes the position that the contractor is entitled to recover the profit and overhead that it would have earned had it completed the project. This is the appropriate result if the contractor could not replace the work. Although it results in something of a windfall if the contractor has a backlog of work, it is probably the appropriate remedy in most cases since the termination was for the convenience of the owner. In any event, this provision is subject to negotiation and the agreement of the parties.

c. Termination for Cause

A termination for cause provision is almost superfluous since in the absence of such a provision a material breach of the contract by one party would excuse performance by the other party. However, the standard termination provisions set out two concepts that are not found in the common law. One is the owner's obligation to provide notice prior to termination and the second is the owner's right to withhold any additional payment to the contractor after termination until final completion of the project and a determination of whether there is a contract balance remaining.

d. Other Remedies

Because termination of the contract is a drastic remedy that almost always results in an increase in the cost to complete the project, the contract should contain additional remedies that are less drastic. For instance, we believe that every contract should give the owner the right to supplement the contractor's work force under certain explicitly defined conditions. For instance, if the contractor falls behind the completion schedule by a stated amount of time and fails to publish a reasonable and attainable recovery schedule.

A101 –Lump Sum Contract
ARTICLE 6 TERMINATION OR SUSPENSION

§ 6.1 The Contract may be terminated by the Owner or the Contractor as provided in Article 14 of AIA Document A201-1997.

§ 6.2 The Work may be suspended by the Owner as provided in Article 14 of AIA Document A201-1997.

A111 – Cost Plus A Fee
ARTICLE 13 TERMINATION OR SUSPENSION

§ 13.1 The Contract may be terminated by the Contractor, or by the Owner for convenience, as provided in Article 14 of AIA Document A201-1997. However, the amount to be paid to the Contractor under Section 14.1.3 of AIA Document A201-1997 shall not exceed the amount the Contractor would be entitled to receive under Section 13.2 below, except that the Contractor's Fee shall be calculated as if the Work had been fully completed by the Contractor, including a reasonable estimate of the Cost of the Work for Work not actually completed.

§ 13.2 The Contract may be terminated by the Owner for cause as provided in Article 14 of AIA Document A201-1997. The amount, if any, to be paid to the Contractor under Section 14.2.4 of AIA Document A201-1997 shall not cause the Guaranteed Maximum Price to be exceeded, nor shall it exceed an amount calculated as follows:

§ 13.2.1 Take the Cost of the Work incurred by the Contractor to the date of termination;

§ 13.2.2 Add the Contractor's Fee computed upon the Cost of the Work to the date of termination at the rate stated in Section 5.1.2 or, if the Contractor's Fee is stated as a fixed sum in that Section, an amount that bears the same ratio to that fixed-sum Fee as the Cost of the Work at the time of termination bears to a reasonable estimate of the probable Cost of the Work upon its completion; and

§ 13.2.3 Subtract the aggregate of previous payments made by the Owner.

§ 13.3 The Owner shall also pay the Contractor fair compensation, either by purchase or rental at the election of the Owner, for any equipment owned by the Contractor that the Owner elects to retain and that is not otherwise included in the Cost of the Work under Section 13.2.1. To the extent that the Owner elects to take legal assignment of subcontracts and purchase orders (including rental agreements), the Contractor shall, as a condition of receiving the payments referred to in this Article 13, execute and deliver all such papers and take all such steps, including the legal assignment of such subcontracts and other contractual rights of the Contractor, as the Owner may require for the purpose of fully vesting in the Owner the rights and benefits of the Contractor under such subcontracts or purchase orders.

§ 13.4 The Work may be suspended by the Owner as provided in Article 14 of AIA Document A201-1997; in such case, the Guaranteed Maximum Price and Contract Time shall be increased as provided in Section 14.3.2 of AIA Document A201-1997 except that the term "profit" shall be understood to mean the Contractor's Fee as described in Sections 5.1.2 and Section 6.4 of this Agreement.

A201
ARTICLE 14 TERMINATION OR SUSPENSION OF THE CONTRACT

§ 14.1 TERMINATION BY THE CONTRACTOR

§ 14.1.1 The Contractor may terminate the Contract if the Work is stopped for a period of 30 consecutive days through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, for any of the following reasons:

- **.1** issuance of an order of a court or other public authority having jurisdiction which requires all Work to be stopped;
- **.2** an act of government, such as a declaration of national emergency which requires all Work to be stopped;
- **.3** because the Architect has not issued a Certificate for Payment and has not notified the Contractor of the reason for withholding certification as provided in Section 9.4.1, or because the Owner has not made payment on a Certificate for Payment within the time stated in the Contract Documents; or
- **.4** the Owner has failed to furnish to the Contractor promptly, upon the Contractor's request, reasonable evidence as required by Section 2.2.1.

§ 14.1.2 The Contractor may terminate the Contract if, through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, repeated suspensions, delays or interruptions of the entire Work by the Owner as described in Section 14.3 constitute in the aggregate more than 100 percent of the total number of days scheduled for completion, or 120 days in any 365-day period, whichever is less.

§ 14.1.3 If one of the reasons described in Section 14.1.1 or 14.1.2 exists, the Contractor may, upon seven days' written notice to the Owner and Architect, terminate the Contract and recover from the Owner payment for Work executed and for proven loss with respect to materials, equipment, tools, and construction equipment and machinery, including reasonable overhead, profit and damages.

§ 14.1.4 If the Work is stopped for a period of 60 consecutive days through no act or fault of the Contractor or a Subcontractor or their agents or employees or any other persons performing portions of the Work under contract with the Contractor because the Owner has persistently failed to fulfill the Owner's obligations under the Contract Documents with respect to matters important to the progress of the Work, the Contractor may, upon seven additional days' written notice to the Owner and the Architect, terminate the Contract and recover from the Owner as provided in Section 14.1.3.

§ 14.2 TERMINATION BY THE OWNER FOR CAUSE

§ 14.2.1 The Owner may terminate the Contract if the Contractor:

- **.1** persistently or repeatedly refuses or fails to supply enough properly skilled workers or proper materials;
- **.2** fails to make payment to Subcontractors for materials or labor in accordance with the respective agreements between the Contractor and the Subcontractors;
- **.3** persistently disregards laws, ordinances, or rules, regulations or orders of a public authority having jurisdiction; or
- **.4** otherwise is guilty of substantial breach of a provision of the Contract Documents.

§ 14.2.2 When any of the above reasons exist, the Owner, upon certification by the Architect that sufficient cause exists to justify such action, may without prejudice to any other rights or remedies of the Owner and

after giving the Contractor and the Contractor's surety, if any, seven days' written notice, terminate employment of the Contractor and may, subject to any prior rights of the surety:

.1 take possession of the site and of all materials, equipment, tools, and construction equipment and machinery thereon owned by the Contractor;

.2 accept assignment of subcontracts pursuant to Section 5.4; and

.3 finish the Work by whatever reasonable method the Owner may deem expedient. Upon request of the Contractor, the Owner shall furnish to the Contractor a detailed accounting of the costs incurred by the Owner in finishing the Work.

§ 14.2.3 When the Owner terminates the Contract for one of the reasons stated in Section 14.2.1, the Contractor shall not be entitled to receive further payment until the Work is finished.

§ 14.2.4 If the unpaid balance of the Contract Sum exceeds costs of finishing the Work, including compensation for the Architect's services and expenses made necessary thereby, and other damages incurred by the Owner and not expressly waived, such excess shall be paid to the Contractor. If such costs and damages exceed the unpaid balance, the Contractor shall pay the difference to the Owner. The amount to be paid to the Contractor or Owner, as the case may be, shall be certified by the Architect, upon application, and this obligation for payment shall survive termination of the Contract.

§ 14.3 SUSPENSION BY THE OWNER FOR CONVENIENCE

§ 14.3.1 The Owner may, without cause, order the Contractor in writing to suspend, delay or interrupt the Work in whole or in part for such period of time as the Owner may determine.

§ 14.3.2 The Contract Sum and Contract Time shall be adjusted for increases in the cost and time caused by suspension, delay or interruption as described in Section 14.3.1. Adjustment of the Contract Sum shall include profit. No adjustment shall be made to the extent:

.1 that performance is, was or would have been so suspended, delayed or interrupted by another cause for which the Contractor is responsible; or

.2 that an equitable adjustment is made or denied under another provision of the Contract.

§ 14.4 TERMINATION BY THE OWNER FOR CONVENIENCE

§ 14.4.1 The Owner may, at any time, terminate the Contract for the Owner's convenience and without cause.

§ 14.4.2 Upon receipt of written notice from the Owner of such termination for the Owner's convenience, the Contractor shall:

.1 cease operations as directed by the Owner in the notice;

.2 take actions necessary, or that the Owner may direct, for the protection and preservation of the Work; and

.3 except for Work directed to be performed prior to the effective date of termination stated in the notice, terminate all existing subcontracts and purchase orders and enter into no further subcontracts and purchase orders.

§ 14.4.3 In case of such termination for the Owner's convenience, the Contractor shall be entitled to receive payment for Work executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.

XI. PERFORMANCE AND PAYMENT BONDS

Another form of protection for the owner is the requirement that the contractor provide Performance and Payment Bonds. The theory being that if the contractor fails to perform its obligations to the owner or to the subcontractors a well capitalized third party

will accept the responsibility for completing the job and/or paying damages for the contractor's failure to perform. Both of the standard form contracts include provisions addressing the existence of such bonds but neither the AIA nor the AGC form contract requires them.

A performance bond, issued by a reputable surety, provides that the bonding company will guarantee that the contractor will complete the project. A payment bond ensures that subcontractors and suppliers are paid for the cost of labor, materials and equipment used on the job and can protect the owner from lien claims.

The law related to surety bonds is complex and a thorough discussion is well beyond the scope of this seminar. It is sufficient here to say that a surety is a form of insurance and like all insurance companies, sureties accept a premium to accept very specific risks. The intent of the parties may be to insulate the owner from financial risks related to the contractor's performance but the actual protection will be narrowly construed by the surety – and perhaps by the court – based upon the actual language included in the bond and not all performance and payment bonds are created equal.

AIA A201

§ 11.5 PERFORMANCE BOND AND PAYMENT BOND

§ 11.5.1 The Owner shall have the right to require the Contractor to furnish bonds covering faithful performance of the Contract and payment of obligations arising thereunder as stipulated in bidding requirements or specifically required in the Contract Documents on the date of execution of the Contract.

§ 11.5.2 Upon the request of any person or entity appearing to be a potential beneficiary of bonds covering payment of obligations arising under the Contract, the Contractor shall promptly furnish a copy of the bonds or shall permit a copy to be made.

AIA A312 PERFORMANCE BOND

§ 1 The Contractor and the Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for the performance of the Construction Contract, which is incorporated herein by reference.

§ 2 If the Contractor performs the Construction Contract, the Surety and the Contractor shall have no obligation under this Bond, except to participate in conferences as provided in Section 3.1.

§ 3 If there is no Owner Default, the Surety's obligation under this Bond shall arise after:
§ 3.1 The Owner has notified the Contractor and the Surety at its address described in Section 10 below that the Owner is considering declaring a Contractor Default and has requested and attempted to arrange a conference with the Contractor and the Surety to be held not later than fifteen days after receipt of such notice to discuss methods of performing the Construction Contract. If the Owner, the Contractor and the Surety agree, the Contractor shall be allowed a reasonable time to perform the Construction Contract, but such an agreement shall not waive the Owner's right, if any, subsequently to declare a Contractor Default; and

§ 3.2 The Owner has declared a Contractor Default and formally terminated the Contractor's right to complete the contract. Such Contractor Default shall not be declared earlier than twenty days after the Contractor and the Surety have received notice as provided in Section 3.1; and

§ 3.3 The Owner has agreed to pay the Balance of the Contract Price to the Surety in accordance with the terms of the Construction Contract or to a contractor selected to perform the Construction Contract in accordance with the terms of the contract with the Owner.

§ 4 When the Owner has satisfied the conditions of Section 3, the Surety shall promptly and at the Surety's expense take one of the following actions:
§ 4.1 Arrange for the Contractor, with consent of the Owner, to perform and complete the Construction Contract; or

§ 4.2 Undertake to perform and complete the Construction Contract itself, through its agents or through independent contractors; or

§ 4.3 Obtain bids or negotiated proposals from qualified contractors acceptable to the Owner for a contract for performance and completion of the Construction Contract, arrange for a contract to be prepared for execution by the Owner and the contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract, and pay to the Owner the amount of damages as described in Section 6 in excess of the Balance of the Contract Price incurred by the Owner resulting from the Contractor's default; or

§ 4.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances:

- **.1** After investigation, determine the amount for which it may be liable to the Owner and, as soon as practicable after the amount is determined, tender payment therefor to the Owner; or
- **.2** Deny liability in whole or in part and notify the Owner citing reasons therefor.

§ 5 If the Surety does not proceed as provided in Section 4 with reasonable promptness, the Surety shall be deemed to be in default on this Bond fifteen days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform its obligations under this Bond, and the Owner shall be entitled to enforce any remedy available to the Owner. If the Surety proceeds as provided in Section 4.4, and the Owner refuses the payment tendered or the Surety has denied liability, in whole or in part, without further notice the Owner shall be entitled to enforce any remedy available to the Owner.

§ 6 After the Owner has terminated the Contractor's right to complete the Construction Contract, and if the Surety elects to act under Section 4.1, 4.2, or 4.3 above, then the responsibilities of the Surety to the Owner shall not be greater than those of the Contractor under the Construction Contract, and the responsibilities of the Owner to the Surety shall not be greater than those of the Owner under the Construction Contract. To the limit of the amount of this Bond, but subject to commitment by the Owner of the Balance of the Contract Price to mitigation of costs and damages on the Construction Contract, the Surety is obligated without duplication for:
§ 6.1 The responsibilities of the Contractor for correction of defective work and completion of the Construction Contract;

§ 6.2 Additional legal, design professional and delay costs resulting from the Contractor's Default, and resulting from the actions or failure to act of the Surety under Section 4; and

§ 6.3 Liquidated damages, or if no liquidated damages are specified in the Construction Contract, actual damages caused by delayed performance or non-performance of the Contractor.

SIMPLER BOND FORM

The PRINCIPAL and SURETY above named, are held and firmly bound unto the above named CONTRACTING BODY, . . ., in the penal sum of the amount stated above in lawful money of the United States, for the payment of which sum well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally by these presents.

THE CONDITION OF THIS OBLIGATION IS SUCH, that whereas, the Principal entered into a certain Contract with the Contracting Body, dated the _____, for work described by Plans and Specifications prepared by _____, herein called and referred to as the Designer, a copy of said Agreement is hereto attached and made a part hereof for the construction of _____.

NOW THEREFORE, if the Principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said Contract . . ., then, this obligation to be void; otherwise to remain in full force and virtue.

XII. INSURANCE

Every construction contract should explicitly set out the types and amounts of insurance coverage that the contractor must obtain and maintain. These requirements should include, at a minimum, the insurance coverages required by law for workers' compensation and other employee benefits and general liability insurance for personal or property injuries incurred on the owner's property. The full extent of proper insurance coverage is a function of the owner's potential liability as the owner and is beyond the scope of this paper. We have included for reference purposes the standard language contained in the AIA A201 contract.

ARTICLE 11 INSURANCE AND BONDS

§ 11.1 CONTRACTOR'S LIABILITY INSURANCE

§ 11.1.1 The Contractor shall purchase from and maintain in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located such insurance as will protect the Contractor from claims set forth below which may arise out of or result from the Contractor's operations under the Contract and for which the Contractor may be legally liable, whether such operations be by the Contractor or by a Subcontractor or by anyone directly or indirectly employed by any of them, or by anyone for whose acts any of them may be liable:

.1 claims under workers' compensation, disability benefit and other similar employee benefit acts which are applicable to the Work to be performed;

.2 claims for damages because of bodily injury, occupational sickness or disease, or death of the Contractor's employees;
.3 claims for damages because of bodily injury, sickness or disease, or death of any person other than the Contractor's employees;
.4 claims for damages insured by usual personal injury liability coverage;
.5 claims for damages, other than to the Work itself, because of injury to or destruction of tangible property, including loss of use resulting therefrom;
.6 claims for damages because of bodily injury, death of a person or property damage arising out of ownership, maintenance or use of a motor vehicle;
.7 claims for bodily injury or property damage arising out of completed operations; and
.8 claims involving contractual liability insurance applicable to the Contractor's obligations under Section 3.18.

§ 11.1.2 The insurance required by Section 11.1.1 shall be written for not less than limits of liability specified in the Contract Documents or required by law, whichever coverage is greater. Coverages, whether written on an occurrence or claims-made basis, shall be maintained without interruption from date of commencement of the Work until date of final payment and termination of any coverage required to be maintained after final payment.

§ 11.1.3 Certificates of insurance acceptable to the Owner shall be filed with the Owner prior to commencement of the Work. These certificates and the insurance policies required by this Section 11.1 shall contain a provision that coverages afforded under the policies will not be canceled or allowed to expire until at least 30 days' prior written notice has been given to the Owner. If any of the foregoing insurance coverages are required to remain in force after final payment and are reasonably available, an additional certificate evidencing continuation of such coverage shall be submitted with the final Application for Payment as required by Section 9.10.2. Information concerning reduction of coverage on account of revised limits or claims paid under the General Aggregate, or both, shall be furnished by the Contractor with reasonable promptness in accordance with the Contractor's information and belief.

§ 11.2 OWNER'S LIABILITY INSURANCE

§ 11.2.1 The Owner shall be responsible for purchasing and maintaining the Owner's usual liability insurance.

§ 11.3 PROJECT MANAGEMENT PROTECTIVE LIABILITY INSURANCE

§ 11.3.1 Optionally, the Owner may require the Contractor to purchase and maintain Project Management Protective Liability insurance from the Contractor's usual sources as primary coverage for the Owner's, Contractor's and Architect's vicarious liability for construction operations under the Contract. Unless otherwise required by the Contract Documents, the Owner shall reimburse the Contractor by increasing the Contract Sum to pay the cost of purchasing and maintaining such optional insurance coverage, and the Contractor shall not be responsible for purchasing any other liability insurance on behalf of the Owner. The minimum limits of liability purchased with such coverage shall be equal to the aggregate of the limits required for Contractor's Liability Insurance under Sections 11.1.1.2 through 11.1.1.5.

§ 11.3.2 To the extent damages are covered by Project Management Protective Liability insurance, the Owner, Contractor and Architect waive all rights against each other for damages, except such rights as they may have to the proceeds of such insurance. The policy shall provide for such waivers of subrogation by endorsement or otherwise.

§ 11.3.3 The Owner shall not require the Contractor to include the Owner, Architect or other persons or entities as additional insureds on the Contractor's Liability Insurance coverage under Section 11.1.

§ 11.4 PROPERTY INSURANCE

§ 11.4.1 Unless otherwise provided, the Owner shall purchase and maintain, in a company or companies lawfully authorized to do business in the jurisdiction in which the Project is located, property insurance written on a builder's risk "all-risk" or equivalent policy form in the amount of the initial Contract Sum, plus value of subsequent Contract modifications and cost of materials supplied or installed by others,

comprising total value for the entire Project at the site on a replacement cost basis without optional deductibles. Such property insurance shall be maintained, unless otherwise provided in the Contract Documents or otherwise agreed in writing by all persons and entities who are beneficiaries of such insurance, until final payment has been made as provided in Section 9.10 or until no person or entity other than the Owner has an insurable interest in the property required by this Section 11.4 to be covered, whichever is later. This insurance shall include interests of the Owner, the Contractor, Subcontractors and Sub-subcontractors in the Project.

§ 11.4.1.1 Property insurance shall be on an "all-risk" or equivalent policy form and shall include, without limitation, insurance against the perils of fire (with extended coverage) and physical loss or damage including, without duplication of coverage, theft, vandalism, malicious mischief, collapse, earthquake, flood, windstorm, falsework, testing and startup, temporary buildings and debris removal including demolition occasioned by enforcement of any applicable legal requirements, and shall cover reasonable compensation for Architect's and Contractor's services and expenses required as a result of such insured loss.

§ 11.4.1.2 If the Owner does not intend to purchase such property insurance required by the Contract and with all of the coverages in the amount described above, the Owner shall so inform the Contractor in writing prior to commencement of the Work. The Contractor may then effect insurance which will protect the interests of the Contractor, Subcontractors and Sub-subcontractors in the Work, and by appropriate Change Order the cost thereof shall be charged to the Owner. If the Contractor is damaged by the failure or neglect of the Owner to purchase or maintain insurance as described above, without so notifying the Contractor in writing, then the Owner shall bear all reasonable costs properly attributable thereto.

§ 11.4.1.3 If the property insurance requires deductibles, the Owner shall pay costs not covered because of such deductibles.

§ 11.4.1.4 This property insurance shall cover portions of the Work stored off the site, and also portions of the Work in transit.

§ 11.4.1.5 Partial occupancy or use in accordance with Section 9.9 shall not commence until the insurance company or companies providing property insurance have consented to such partial occupancy or use by endorsement or otherwise. The Owner and the Contractor shall take reasonable steps to obtain consent of the insurance company or companies and shall, without mutual written consent, take no action with respect to partial occupancy or use that would cause cancellation, lapse or reduction of insurance.

§ 11.4.2 Boiler and Machinery Insurance. The Owner shall purchase and maintain boiler and machinery insurance required by the Contract Documents or by law, which shall specifically cover such insured objects during installation and until final acceptance by the Owner; this insurance shall include interests of the Owner, Contractor, Subcontractors and Sub-subcontractors in the Work, and the Owner and Contractor shall be named insureds.

§ 11.4.3 Loss of Use Insurance. The Owner, at the Owner's option, may purchase and maintain such insurance as will insure the Owner against loss of use of the Owner's property due to fire or other hazards, however caused. The Owner waives all rights of action against the Contractor for loss of use of the Owner's property, including consequential losses due to fire or other hazards however caused.

§ 11.4.4 If the Contractor requests in writing that insurance for risks other than those described herein or other special causes of loss be included in the property insurance policy, the Owner shall, if possible, include such insurance, and the cost thereof shall be charged to the Contractor by appropriate Change Order.

§ 11.4.5 If during the Project construction period the Owner insures properties, real or personal or both, at or adjacent to the site by property insurance under policies separate from those insuring the Project, or if after final payment property insurance is to be provided on the completed Project through a policy or policies other than those insuring the Project during the construction period, the Owner shall waive all

rights in accordance with the terms of Section 11.4.7 for damages caused by fire or other causes of loss covered by this separate property insurance. All separate policies shall provide this waiver of subrogation by endorsement or otherwise.

§ 11.4.6 Before an exposure to loss may occur, the Owner shall file with the Contractor a copy of each policy that includes insurance coverages required by this Section 11.4. Each policy shall contain all generally applicable conditions, definitions, exclusions and endorsements related to this Project. Each policy shall contain a provision that the policy will not be canceled or allowed to expire, and that its limits will not be reduced, until at least 30 days' prior written notice has been given to the Contractor.

§ 11.4.7 Waivers of Subrogation. The Owner and Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance obtained pursuant to this Section 11.4 or other property insurance applicable to the Work, except such rights as they have to proceeds of such insurance held by the Owner as fiduciary. The Owner or Contractor, as appropriate, shall require of the Architect, Architect's consultants, separate contractors described in Article 6, if any, and the subcontractors, sub-subcontractors, agents and employees of any of them, by appropriate agreements, written where legally required for validity, similar waivers each in favor of other parties enumerated herein. The policies shall provide such waivers of subrogation by endorsement or otherwise. A waiver of subrogation shall be effective as to a person or entity even though that person or entity would otherwise have a duty of indemnification, contractual or otherwise, did not pay the insurance premium directly or indirectly, and whether or not the person or entity had an insurable interest in the property damaged.

§ 11.4.8 A loss insured under Owner's property insurance shall be adjusted by the Owner as fiduciary and made payable to the Owner as fiduciary for the insureds, as their interests may appear, subject to requirements of any applicable mortgagee clause and of Section 11.4.10. The Contractor shall pay Subcontractors their just shares of insurance proceeds received by the Contractor, and by appropriate agreements, written where legally required for validity, shall require Subcontractors to make payments to their Sub-subcontractors in similar manner.

§ 11.4.9 If required in writing by a party in interest, the Owner as fiduciary shall, upon occurrence of an insured loss, give bond for proper performance of the Owner's duties. The cost of required bonds shall be charged against proceeds received as fiduciary. The Owner shall deposit in a separate account proceeds so received, which the Owner shall distribute in accordance with such agreement as the parties in interest may reach, or in accordance with an arbitration award in which case the procedure shall be as provided in Section 4.6. If after such loss no other special agreement is made and unless the Owner terminates the Contract for convenience, replacement of damaged property shall be performed by the Contractor after notification of a Change in the Work in accordance with Article 7.

§ 11.4.10 The Owner as fiduciary shall have power to adjust and settle a loss with insurers unless one of the parties in interest shall object in writing within five days after occurrence of loss to the Owner's exercise of this power; if such objection is made, the dispute shall be resolved as provided in Sections 4.5 and 4.6. The Owner as fiduciary shall, in the case of arbitration, make settlement with insurers in accordance with directions of the arbitrators. If distribution of insurance proceeds by arbitration is required, the arbitrators will direct such distribution.

§ 11.5 PERFORMANCE BOND AND PAYMENT BOND

§ 11.5.1 The Owner shall have the right to require the Contractor to furnish bonds covering faithful performance of the Contract and payment of obligations arising thereunder as stipulated in bidding requirements or specifically required in the Contract Documents on the date of execution of the Contract.

§ 11.5.2 Upon the request of any person or entity appearing to be a potential beneficiary of bonds covering payment of obligations arising under the Contract, the Contractor shall promptly furnish a copy of the bonds or shall permit a copy to be made.