

Understanding Construction Contracts

Construction contracts can contain terms that impact your company's bottom line. Reviewing them carefully prior to signing is indispensable, and can save your company time and money. This contract review guide is meant to be a starting point for reviewing contracts in general. It highlights some common contract terms and their potential impact. You can begin to understand which terms are most often negotiated in contracts generally. Then, with the help of licensed inside or outside counsel, analyze the commercial risks associated with construction contracts in depth and understand terms and conditions to protect your company's assets.

Scope of the Agreement

Examine the definition of services to be provided to ensure the language is clear enough for an unrelated third party to understand the scope. The contract should include a time frame for completion of services. The rights and obligations of both parties should be clearly outlined. Any mechanism for changing the scope of the contract, as well as any of the terms, if allowed, should also be outlined within the contract.

Terms of Payment

Terms of payment should be clearly listed within the contract so that the expectations of both parties are clear. The contract should specify the agreed payment schedule for goods received.

Warranties

There are two types of warranties: express and implied. Both types are assurances regarding particular issues, such as performance.

Express warranties are those that are defined specifically in the contract. Implied warranties are based in statutory and/or common law, depending upon your jurisdiction. They are two-fold: a warranty of merchantability, which requires that goods/services must reasonably conform to an ordinary buyer's standards, and a warranty of fitness for a particular purpose, which states that if a seller knows the intended purpose for the product or service, the act of selling the product to that customer implies that it is fit for that purpose.

With a reviewer's help, analyze the commercial risks associated with construction contracts and understand terms and conditions to protect your company's assets.

Be aware of warranty disclaimers and understand how the disclaimer limits your statutory rights. If it disclaims all warranties, express and implied, then you will likely be limited to the remedies in the contract for issues related to things like performance. You should also examine any disclaimer in the context of the contract. While it may require you to disclaim your statutory rights, other contract language may give you adequate rights and remedies regarding the points about which you are most concerned.

Damages, Limits of Liability and Indemnification

These three items are often in close proximity to one another in a contract, as they are interrelated. Damages

Provided by Absolute Integrity Insurance

Understanding Construction Contracts

may be defined as certain types of losses that could create liability under the contract. A limit on liability would restrict the amount of damages that a party would be required to pay if found liable for such damages. Sometimes this may also include a limit for indemnification.

Indemnification provisions allocate risk and cost between the parties. It is important to examine whether the party assuming the risk is the party with the most control over that risk. For instance, when a company's employees are required to work at a customer's location, the company is often asked to release the customer from all liability relating to the employees presence at the customer's location.

In some cases, indemnification is limited to negligence or to a specific dollar amount, under a heading of "limits of liability."

Insurance

Some contracts will contain minimum bodily injury and property damage liability coverage amounts that the party must possess and also may require that the customer is added as an additional insured on those coverages.

Prior to consenting to any contract, it is prudent to examine insurance coverage against the amount of liability exposure in a particular contract.

Terms and Conditions

It is also vital to examine any terms and conditions contained in the contract:

- **Governing Law & Jurisdiction** – Look at the governing law provision to make sure that you are comfortable with the implications of the state law chosen by the drafter. This can impact the interpretation of the contract from warranties to indemnification.

Additionally, when specific statutes or regulations are referenced in the body of a contract, it is as

though that statute or regulation is wholly contained within the contract itself. It is vital to read and understand that language prior to giving your consent. This happens regularly in government contracting situations.

- **Dispute Resolution** – This is another clause with which you must be comfortable with the laws of the state or forum chosen by the drafter. The rules chosen to govern dispute resolution can impact the outcome. Additionally, you should consider whether dispute resolution is right for your situation.
- **Intellectual Property** – When you are disclosing and/or licensing your company's intellectual property, be it trademarks, copyrights or patents, it is important to include a clause that recognizes the owner of such intellectual property and affirmatively states that the agreement does not transfer any rights.
- **Standard of Care** – A standard of care clause may appear in certain types of contracts. The standard of care that is provided by the law should provide the minimum standard of care for the provision of services under the contract.
- **Term/Termination** – The contract should provide both parties with the right to terminate the contract. The situations in which termination is allowed will vary from contract to contract. Some contracts will allow the right to terminate in cases of dissatisfaction; others will allow it with a specific notice, for no cause. It is important that you contemplate in what cases you would want the right to terminate the contract. There should also be language defining the term of the contract. Does it have a finite term? Does it automatically renew each period?
- **Right to Cure** – Related to termination, some contracts will contain a right to cure clause. This would give the defaulting party notice of a breach

Understanding Construction Contracts

and a finite period of time in which to remedy such a breach.

Standard Form Contracts

Unlike other industries, construction lacks a consistent set of laws like the Uniform Commercial Code or a federal statutory scheme. Contracts produced by professional and trade associations for architects (American Institute of Architects), engineers (Engineers Joint Contract Documents Committee) and commercial contractors (Associated General Contractors of America) can serve as important references and benchmarks when drafting a new contract. They are a good source of industry best practices, and using them can greatly reduce drafting and review time, meaning lower overall transaction costs for your company.

For all of their advantages, there are several things that you should be cautious about when using standard form contracts. Note the following cautions about standard forms before using them:

- Standard forms, which are written broadly to encompass many different contexts, require transaction-specific and jurisdiction-specific modifications. For example, certain states require that indemnities be written in a certain way.
- Changes made to one part of the document, such as definitions of words or terms, may affect other parts that make reference to it.
- Custom-drafted and industry-drafted forms are often incompatible. Even industry-drafted forms from different publishers can be incompatible.
- Standard forms always contain the bias of the drafter. Use this bias; know when to use various standard forms published by different industry organizations.

General Understanding

Reviewing general terms and features of construction

contracts will help you grasp the consequences of its terms and conditions for your business. In any case, to ensure its completeness and accuracy, it is necessary to submit each contract you must sign to legal review.