Dinsmore

Show Me the Money: Plan Now or Be Prepared to Pay More Later

Top 10 Considerations in Contract Pre-Planning

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Introduction

In the movie Jerry Maguire, Jerry (played by Tom Cruise) is a sports agent who is fired by his sports management firm and loses most of his clients. Jerry must convince his last client, a talented but underappreciated football player, to stay with him instead of going to his competitor. The client implores Jerry to "Show him the money" and convinces Jerry to repeatedly yell in his office "Show me the money!" in order to show Jerry's commitment to his client.

In the context of construction, clients expect their lawyers to show the same level of commitment. The best way attorneys can show clients "the money" is in the pre-planning stage. The costs of litigation and dispute resolution consistently dwarf the expenses associated with proper pre-construction planning. A recent survey found that the average value of construction disputes increased by 42% in 2022 and the leading cause of these disputes was errors and/or omissions in the contract documents.[i]

Construction litigation is generally complex and involves multiple parties tied together on a project through layers of agreements that often do not align. When these contracts do not fit together or lack guidance on significant issues, the cost impact to the parties can be devastating. Once a dispute arises, it is often too late. For this reason, we strongly encourage pre-planning with our clients to help them get the most out of their projects and to control and reduce the risks of litigation.

The following article is meant to serve as a blueprint of critical factors to consider when planning and developing contracts for construction projects. While pre-planning may not alleviate every challenge that can arise, it will help to manage problems and minimize disputes. This article touches on ten key contract areas that should be addressed to avoid costly pitfalls in construction projects.

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Choose the Right Form of Agreement for the Project

Picking the right type of agreement is a fundamental decision in every project

Each of these factors should be taken into account when selecting the type of agreement for the project. Construction projects come in a variety of shapes and sizes, and it is important to tailor agreements to the particular project and its needs. In addition to these factors, it is important that the contracts for the project are cohesive, including those with design professionals, consultants and the subcontractors. Coordinating and planning these agreements gives projects the best chance of weathering any problems that arise in predictable and structured ways.

There are several types of project agreements and pricing models for parties to consider, and while we will not detail all of them, we will address some of the most widely used.

Common Types of Agreements:

A. Design, Bid and Build

A Design-Bid-Build framework for project agreements is the most common method for project delivery. These types of agreements are often required by the nature of the project (e.g. public works) or they are used because they are familiar. Although familiarity can be a positive, one drawback is that a Contractor is not involved during the design phase. This can result in missing constructability, phasing, and cost saving opportunities. This limitation can be addressed by hiring a Construction Manager as a Consultant or Constructor to allow for the benefit of value engineering during the design process.

B. Design Build

Owners use Design-Build agreements when they want the entire project to be delivered by one entity, usually in circumstances where the General Contractor retains the Design Professionals. This limits the opportunity for the design and construction teams to point the finger at one another at the Owner's expense. It can also increase project efficiency by ensuring design and constructability issues are coordinated from the outset. However, selection of the design-builder occurs well before final pricing can be established and may impact the timing of financing and lose some benefit of competitive bidding.

C. Engineering, Procurement and Construction (EPC)

An EPC agreement is often used on more technical projects. This type of agreement has real appeal because it enables one entity to handle the design, construction, installation, and commissioning of very technical systems. However, the bidding process can be time consuming, expensive and financing may complicate matters.

Key considerations

- Is cost certainty more important than getting the best possible price?
- Does the schedule require expedited and coordinated value engineering during the design process?
- Is the project highly technical and specialized? If so, the project may require phase pricing with design, construction and commission of systems incorporated into the real estate.
- Does the project have financing requirements? If so, there may be less flexibility with pricing.

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Pricing Models:

A. Lump Sum/Stipulated Sum

A Lump Sum or Stipulated Sum price model involves a specific scope of work for a specific lump sum. This is common with Design-Bid-Build projects. For Design Work, this is the most common pricing approach, with additional or supplemental services charged on an hourly basis. For Owner Contractor Agreements and Subcontract Agreements, the price often comes as the result of competitive bidding scenarios with the assumption that the competition will lead to the best pricing. While the Lump Sum approach provides predictability and greater ease of administration than some other approaches, it may lead to a false sense of security if the scope of work fails to close all loopholes. It also lacks transparency about the actual cost to the contractor and its level of profits.

B. Cost-Plus-Fixed-Fee

A Cost-Plus-Fixed-Fee model ensures some control over the amount of profit taken by the Contractor, but can be expensive to administer by the Owner and requires experience with auditing such expenses. It also does not provide any cap for the cost associated with project completion. With these agreements, defining what is captured by the term "Cost" becomes essential.

C. Cost-Plus with a Guaranteed Maximum Price ("GMP")

A Cost-Plus with a GMP can be used where an Owner wants cost transparency and an assurance on the total amount. It may be the preferred model where there is financing or investors. With both Stipulated Sum and GMP Agreements, change orders can impact pricing. As a result, the risk of price fluctuation remains, but it is subject to meaningful control.

D. Other Considerations

With both Design-Build and Construction Manager as Constructor Agreements, construction pricing comes later in the process, based upon amendments to the agreement after the design process is complete. The design work and value engineering are completed prior to establishing the construction pricing.

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Scope of work

One of the most widely disputed issues with construction projects centers around scope of work issues and who is responsible.

2

As a result of the commonality of disputes in scope of work, it is critical to have a detailed scope of work set out in the contract and to understand who will be responsible for each item of work. Scope begins with the drawings and specifications for the project.

When properly planned for and detailed in the contract documents, these tools provide pricing guardrails and guidance that reduce surprises that could delay or add cost to the project.

Drawing and Specifications:

1. Do they meet the Owner's objectives?
2. Are they sufficiently detailed?
3. Has the Contractor visited the site to verify that it has what it needs to construct the project?
4. Has the Contractor tried to exclude any work established by the Drawing and Specifications in its proposal or attempted to incorporate its own proposal into the contract?
5. From the Contractor's perspective, have its subcontractors attempted to exclude anything from their scopes that will become the Contractor's responsibility?
6. Does the Contractor have any Design-Build responsibilities (e.g. Mechanical, Electrical or Plumbing, Fire Suppression, etc.)?

The goal should be to have no gaps in responsibility on the project. Gaps and delays on Owner decisions that impact the scope of work can be addressed through the use of alternates, allowances and other contractual tools.

Alternates are variations to the existing design with a specific cost assigned.

Allowances are rough estimates of work that have been excluded from firm-specific pricing due to open issues, such as final finish selections.

Catch-All Provisions and **Order of Precedence Provisions** seek to minimize potential gaps with broad language.

Contingencies can be used to address the possibility of omissions or miscalculations in establishing a GMP, where the mistakes and omissions do not arise to the level of requiring a change order. They can be allocated to Owners or Contractors and typically must be claimed and documented.

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Communication

We have all heard the golden rule that we need to "Communicate, Communicate and Communicate."

3

Communication is no different in construction. All parties need to be on the same page throughout the project. Clearly defining the lines and forms of communication will pay big dividends and help avoid unnecessary disputes.

Party Representatives
Identify them and define their authority.

Notices
What, when and how provided?

Form
What forms of communication are acceptable for what purposes?

Mandatory Meetings
Sign-in sheets, minutes, and action items should be part of each meeting. Documentation of these meetings is critical to accurately reflect what takes place throughout the project.

Project Software and Technology
While we are not here to promote any particular application, the type of application should be one that the Owner, Architect and Contractor have experience using. Another area of project communication is Building Information Modeling ("BIM"). If BIM is used on a project, having a clear understanding of what BIM communicates to the parties and its limits is necessary.

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Change Orders

4

Change Orders address issues not contemplated in the original drawings, specifications and schedule and involve a change to the contract scope of work, the contract price or contract time.

Key considerations

- Who prepares the proposed Change Order?
  - This is an important starting point for who triggers the process.
- When must it be submitted?
  - Often, it is required before performing the work that is the subject of the Change Order.
- What happens if there is no agreement?
  - A threshold question is whether the work is required to move forward if there is no agreement on price. Another threshold issue arises when there is no agreement as to whether the work at issue should be the subject of a change order.
- What details must be included?
  - The clearer the detail requirements for the scope of the work and the pricing, the better.
- Who decides if a Change Order is appropriate or necessary?
  - Often, parties seek feedback and sometimes approval as to scope of the work from the Architect.

Sometimes, Change Orders arise from Owner decisions to modify design or materials. Change Orders may also arise from design omissions or casulaty losses. Often, parties are unsure of changes, whether in pricing or timing until the work has begun. In Indiana, Change Order requirements are usually strictly enforced and are often paired with a non-waiver provision.[ii]

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The Schedule

5

It is often critical that every trade adheres to its schedule so that other trades are able to perform their work timely and properly.

Another significant issue in construction projects centers around the schedule of the project.

In some cases, it is imperative that the Owner gets the project up and running as soon as possible. For example, many projects need to be fast moving in order to meet certain supply contract deadlines and may require alternative contracting approaches to meet scheduling demands (e.g. Design-Build or EPC). Certain public works projects may have governmental requirements that mandate completion by a certain date.

If the project is not complete, the Owner may insist on delay damages. Likewise, Contractors may seek an incentive to get the project done early in order to receive a substantial early-completion bonus. Delays often have a compounding effect and can result in hiring and staffing delays, loss of business opportunities and other indirect damages. It is also imperative to understand a party's ability to extend the schedule. During the COVID-19 pandemic, many projects had significant schedule delays due to labor shortages resulting from quarantines. Supply chain issues led to material shortages that caused further delays (and cost fluctuations). Formulating contract terms that set criteria for moving milestones and deadlines, and address the allocation of risk of delay deadlines, is the preferred way to manage both expected and unanticipated delays.

Key considerations

- When will the project be complete? Who decides?
  - Typically the Owner has a target date and the Owner and Architect assess whether the project has reached completion.
- How will progress be measured?
  - Oftentimes, progress is measured against established milestones and critical path elements.
- How will performance quality issues be handled?
  - When mistakes happen there are many tools such as acceleration and supplementation that can help keep the project on time.
- Who controls the schedule?
  - The Contractor typically controls the means and methods, sequencing and coordination of the work. However, changes in the contract time have to be approved by the Owner after a written request with support for the change.
- What happens if there is going to be a delay on the project?
  - This is best addressed by putting the responsibility or risk of delay on the party expected to be in the best position to control or anticipate it.
- Will the parties consider having liquidated damages to compensate for those delays and, if so, how and when will they be triggered?
  - There is a need to have some reasonable basis for the valuation and for any payment required to not just be a penalty.
- What is a force majeure event?

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Claims

6

Claims can have a serious impact on a project, so establishing a clear understanding of the parties' roles in the claim process, the timing requirements and their potential impact is a critical part of pre-planning.

As stated earlier, the "perfect project" does not exist. The parties need to be able to roadmap the claim process and set out how a claim will be handled.

Warranty Claims - Typically, these come after project completion. However, depending on the nature, sequencing and parties involved in the project, warranty issues can come into play even during the project. It is absolutely critical that the parties define who is going to be responsible for initiating these claims. For example, is the Owner responsible for initiating the warranty claims? Or, is the Contractor responsible for doing it on the Owner's behalf when the failure involves its Subcontractor?

Key considerations

- How does a party pursue a claim that arises on the project?
  - This is best handled by claims being made in writing and within a set time period
- Must the Contractor continue to work while its claim is pursued?
  - Often, it is in the best interests of the project to keep the work moving forward.
- Will the Architect be the initial manager of the claims process or will it be up to the Owner or its Construction Manager?
- What if the claim involves significant delays?
- Will the Contractor be limited to only additional contract time or will it also be entitled to additional compensation?
- When will the alternative dispute resolution process (ADR) be triggered?
- What if the project or portions of it need to be stopped as a result of the defective work or other delays?
  - Who will be responsible for fixing the defective work?

Litigate, Arbitrate, Mediate

If a claim does not get resolved through the initial contractual claim process, what happens next?

This choice can have significant cost implications. Often, parties incorporate provisions meant to avoid litigation or arbitration, such as stepped negotiations or mandatory pre-litigation/pre-arbitration mediation. Such prerequisites are critical because many lawsuits and arbitrations can be avoided if mandatory dispute resolution procedures are in place. These prerequisites should be incorporated into contracts for the project and the dispute resolution process should be consistent with all contracts to the greatest extent possible. Even if the claim process is unsuccessful and pre-litigation negotiations and/or mediation fail, both are important steps to resolving a dispute. These processes allow for the exchange of relevant information and force substantive communication between the parties, even if a resolution is not immediately achieved.

Problems when mechanisms for resolving disputes are not properly pre-planned and coordinated.

We have had a number of cases that involved multiple parties where pre-planning did not occur. As a result, when we went to the contract documents to determine how to handle the dispute, the contracts were inconsistent. In one such case, there were separate contracts for the Architect and the Owner, the Engineer and the Owner, the Construction Manager and the Owner, and the Prime Contractors and the Owner. Each of the contracts required a different venue for handling the dispute, and it became incredibly costly for all parties involved. For instance, one party's contract allowed for mandatory arbitration, without the ability to consolidate other claims against it in other venues. As a result, this party refused to participate in any state or federal court litigation. This is just one example of an issue that could have been avoided had the parties conducted the proper pre-planning.

Arbitration v. Litigation

Do the parties want the dispute to be in public view? There may be many reasons for either or all parties to keep the details of the dispute private, including pricing and/or any impact on the value of the project

- **Cost Considerations**
  The parties have to pay the arbitrator. They do not pay judges. If the dispute is large enough, the parties may have to pay three arbitrators.
- **Time considerations**
  Arbitration is often expedited compared to litigation. However, with the advent of specialized commercial courts in Indiana, there may be less of a time difference.
- **Level of complexity and industry technicality**
  Where matters are exceedingly technical or complex, having specialized arbitrators with significant construction experience may lead to a better and more efficient result.
- **Number of potential parties**
  With a large number of parties, the costs of arbitrators can be spread around and therefore mitigated. The flexibility of arbitration may help bring efficiency to such cases.

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Insurance, Indemnity and Bonds

8

Insurance, indemnity and bond provisions are essential contract provisions for addressing risk allocation.

We could write a book on the critical importance of having the proper amounts and types of insurance coverage for the project. This means involving insurance brokers with construction industry experience from the outset of project planning. When this does not happen, significant problems can arise.

For example, on a public works project in excess of $100 million dollars, a design defect stopped the project for weeks and involved numerous claims for delay and recoupment of damages. However, the design team only had $1 million in professional liability coverage and claims were made for design defects in excess of the professional coverage in place. Such circumstances raise significant questions, such as who is going to pay the amount over the insurance coverage and whether the design team has the ability to pay any excess amounts of the insurance.

Additionally, it is imperative the parties understand who is going to be responsible for obtaining the coverage, the type of coverage and the amount of coverage. They also need to agree what documentation will be required to establish that all parties to the project, including design professionals, consultants, contractors and sub-subcontractors, have the appropriate insurance coverage in place.

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Insurance reduces, but does not eliminate, risk. In many construction disputes, questions about the scope and availability of coverage are litigated in separate actions based on a variety of issues.[iii] Insurance provides for both defense and indemnity with respect to a variety of potential liability claims on a project. Obtaining the proper coverages for a project can help to reduce exposure to attorneys' fees and litigation costs with respect to those types of claims (e.g. personal injury and defect cases) in addition to potentially covering some or all of the damages at issue. It is important to define the relationship between the various parties' policies, especially where contracts call for additional insured status for other parties. On some projects, parties may seek more protection by requesting umbrella or excess coverage. On very large projects, the parties may choose entirely different approaches to insurance such as Owner-Controlled or Contractor-Controlled Insurance Programs.

A waiver of subrogation rights allow the parties to allocate certain construction risks to their insurers. In turn, such waivers will inhibit the recovery of damages covered by property insurance, regardless of whether the damage was to the work or to other property.[iv] It is essential to make sure that the insurance coverage is consistent with the contractual requirements.

Indemnity

Indemnity provisions are different and often extend to areas that may not be within the scope of insurance coverage. In such provisions, one party to the contract (the Indemnitor) agrees to defend and hold harmless another party (Indemnitee) from damages arising from, or related to the Indemnitor's conduct on the project. Indemnity provisions may also require the Indemnitor to indemnify the Indemnitee's own negligence, but there are limits to such indemnification that must be honored.[v]

Bonds

Bonds typically come in two forms: performance and payment. A performance bond is designed to protect the party paying for the work from non-performance by the Contractor or Subcontractor performing the work. A payment bond protects the project owner from the contractor failing to pay its subcontractors.

Factors

- the rating of the surety,
- the amount of the bond,
- the conditions for triggering the surety's obligations, and
- costs associated with obtaining the bond(s) are all items for negotiation.

On public projects, payment bonds replace mechanic's liens due to public policy against liens being recorded against public property established by statute.[vi] Claims on such payment bonds are subject to statutory requirements.

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Work Stoppages and Termination

9

At times there are claims that require a stoppage of the work.

In these cases, it is critical for all parties to understand if there will be compensation granted, if there will be extensions of time and when the work will commence.

Termination is a delicate process that demands careful attention to detail. Usually, termination should be a last resort given the practical and legal considerations. If the termination is not for a material breach, the terminating party could subject itself to liability.[vii] As a result, when drafting a termination provision, a party should consider who can terminate the contract and under what circumstances.

Each party should also consider how the project will be handled after the termination. Can the Subcontractors' agreements be assigned to the Owner? What are the costs of replacement contractors and further delays, as well as a party's ability to recover these costs? Most of these uncertainties can be addressed through a detailed termination provision, which can help avoid expensive complications during litigation.

Key considerations

- Can the Owner terminate for convenience? This raises questions about what the Contractor receives in the event of termination - lost profits, cost of work completed or a termination fee?
- What process must be followed to allow for termination? Issues include notice, opportunity to cure, timing and others.
- What breaches are considered material?
- Non-payment – can the Subcontractor walk off the job? What about *pay when paid* and *pay if paid* provisions?
- Contractor and Subcontractor rights? Should they be given – when?

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Attorney Fees and Damages

10

The ability of an Owner, an Architect, Engineer or a Contractor to be able to recover its attorney's fees provides tremendous leverage when there is a risk of multi-million dollar litigation or arbitration.

Whether the project is several thousands of dollars or in excess of $100 million dollars, construction disputes are very often expensive to resolve through litigation or arbitration due to the number of parties and the many complex reasons that issues arise. If a claim or dispute arises, and a party knows that it could pay thousands and sometimes seven figures in attorney's fees, avoiding legal costs becomes an even more powerful incentive for resolution. However, attorneys' fee provisions, if not carefully drafted or when there is a mixed result and "prevailing" requires interpretation, can be the subject of significant dispute as well. [viii]*See Boyer Constr. Grp. Corp. v. Walker Constr. Co.,* 44 N.E.3d 119, 121 (Ind. Ct. App. 2015).

The parties should consider additional damage provisions. For example, do the parties wish to include or waive consequential damages? Parties may attempt to insert limitations on general damages. If a project is delayed, what does that mean to the parties? Sometimes delay damages can create significant damages to the Owner and consequential damages may be difficult to prove. In turn, Contractors may be reluctant to agree to consequential damages. As a result, parties sometimes consider having Liquidated Damages to compensate an Owner should the project be delayed as a result of the Contractor or its Subcontractor's fault. Likewise, Contractors may insist on having Early Completion Bonuses.

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Conclusion

Benjamin Franklin said, “By failing to prepare, you are preparing to fail.”

Many times, parties do not consider what will happen when something goes wrong. Failure to plan and allocate risk can have devastating impacts to the parties and the project. Dinsmore’s Top 10 Pre-Planning Considerations are by no means an exhaustive list, but they can be a guidepost and a building block to set a solid foundation.

In Jerry Maguire, Jerry gets frustrated with his only remaining client and explains that he is out there battling for him. However, he needs his client to help him do so and repeats the line “Help me, help you. Help me, help you.” Involving counsel on the front end helps the lawyer help the client and the project.

Every construction project comes with unexpected challenges and potentially costly setbacks. Many can be avoided with proper pre-planning. At Dinsmore, we are here to help you in all aspects of the construction process, while minimizing your risks and increasing your profits.

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[i] Roy Cooper, et al., *13th Annual Construction Disputes Report*, North America | 2023

[ii] See, e.g. Weigand Constr. Co. v. Stephens Fabrication, Inc., 929 N.E.2d 220 (Ind. Ct. App. 2010)(contractor granted summary judgment on subcontractor's claim for costs of additional work due to subcontractor's failure to comply with deadline for asserting claims in the claims provision of the contract) and *Boyer Corp. Excavating v. Shook Constr.*, 2011 Ind. App. Unpub. LEXIS 1730 (Ind. Ct. App. 2011) *citing Weigand* at *24 (finding contractor had waived claims arising from alleged "extra work" by failure to obtain a change order or assert a timely claim)

[iii] *See, e.g. Sheehan Constr. Co. v. Cont'l Cas. Co.,* 935 N.E.2d 160 (Ind. 2010)(finding that coverage under a CGL policy was a fact issue that required a determination of whether the defective work was done intentionally or not – if done intentionally then there would be no accident and no coverage); *Amerisure, Inc. v. Wurster Constr. Co., Inc.*, 818 N.E.2d 998 (Ind. Ct. App. 2004)(holding that lack of an occurrence of property damage precluded insurance coverage)

[iv] *See Bd. of Comm'rs v. Teton Corp.*, 30 N.E.3d 711, 712-13 (Ind. 2015)

[v] *See* Ind. Code 26-2-5-1.

[vi] *See e.g., Elec. Specialties, Inc. v. Siemens Bldg. Techs.*, 837 N.E.2d 1052 (Ind. Ct. App. 2005).

[vii] *F. E. Gates Co. v. Hydro-Technologies*, 722 N.E.2d 898, 899 (Ind. Ct. App. 2000) (denying contractor's breach of contract claim and awarding subcontractor damages for improper termination of the subcontract).

[viii] *See Boyer Constr. Grp. Corp. v. Walker Constr. Co.,* 44 N.E.3d 119, 121 (Ind. Ct. App. 2015).

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