Once you have signed a contract with a "bet the company clause," any dispute you enter becomes a salvage operation—and even the best and most creative construction lawyer may not be able to undo what you have signed.

conference preview

"BET THE COMPANY" CONTRACT CLAUSES AND HOW TO AVOID THEM

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THE GOAL IN NEGOTIATING a construction contract is to clearly define the scope of work, payment for the work and the roles and responsibilities of each party. Most importantly, the contract should appropriately allocate the risk among the construction participants. Unfortunately, many contracts contain onerous contract clauses that attempt to place undue risk on one party. Your ability to eliminate or mitigate those contract clauses will help avoid potential "bet the company" claims on the construction project.

Risk Management

The following rules of risk management should be employed when negotiating a construction contract:

1. The party that is in the best position to control a risk should be the party to take responsibility for the risk
2. If you are in a position where you cannot control a risk, you should try to transfer it to someone else who can control it
3. If you cannot control a risk and cannot transfer it to someone else, you should manage it through insurance

In general, contract provisions that make a fabricator responsible for a general contractor's negligence (like many indemnity clauses), prohibit a fabricator's right to recover legitimate additional costs incurred on the project or expose the fabricator to unreasonable damages should be eliminated or negotiated such that the party who can control the risk is responsible for the risk.

Payment

Virtually every contract dispute involves a disagreement over the amount of payment owed by one party to another. For this reason, it is essential that the payment terms of the contract be fair and clear.

One of the payment terms a general contractor may put in its subcontracts is the "pay-if-paid" clause. This term provides that before the contractor is required to pay the fabricator, the contractor must first be paid by the owner. This term is a problem for the fabricator for many reasons, not the least of which is that it places the risk of payment on the relationship between the general contractor and the owner. It is possible that the general contractor is not getting paid by the owner due to an issue having nothing to do with the fabricator's work. In order to mitigate this risk, it is important to negotiate this clause out of your contract and make sure you have either mechanic's lien rights or a payment bond under which you can pursue payment.

Another problematic payment clause is a lien waiver clause. Lien waiver clauses can take two forms. The first may require the fabricator to waive the right to file a lien under any circumstances. This provision prohibits the fabricator from asserting a statutory right to file a lien. While these provisions are unenforceable in many states, they should be avoided and removed from subcontracts wherever possible. The other type of lien waiver provision requires the fabricator to waive the right to file a lien for work performed after payment is received. This type is more common and, generally, does not present a problem. However, the fabricator must be careful not to waive claims for unresolved changed work when it signs the lien waiver for payment received for other, completed work—and ensure it maintains its lien or bond rights for unpaid work on the project.

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Change Order Provisions

A vast majority of the claims arising on construction projects have to do with disputes over change orders. The key issues in change order disputes involve the following questions:

1. Is it indeed a change?
2. Who is responsible for the change?
3. How much will the change cost?
4. How much additional time is needed?
5. Should work proceed if an agreement on the change cannot be reached?
6. Was appropriate notice given?

The first step in avoiding change order disputes is to have a clearly defined scope of work. In order to know if there is a change to the work, you must first be able to define the original scope of work. Therefore, a clearly defined scope of work is imperative.

Most contract change order provisions require the fabricator to provide notice of the change within a specified period of time. It is important to ensure that adequate time is allowed to recognize that there has been a change and to notify the general contractor of the change.

Some change order provisions require the fabricator to proceed with the changed work even if there has not been an agreement reached as to a change order. These provisions can create a serious problem for a fabricator who is asked to proceed with changed work before there is an agreement by the contractor or owner to pay for that work. A more appropriate contract change provision is to require the fabricator to proceed with undisputed work and to allow the disputed work to be resolved through the dispute resolution process of the contract.

Contract Time and Delays

Delays on a construction project can result in significant additional cost to all parties involved. Therefore, it is important to have clear and fair provisions dealing with the manner in which delays will be compensated.

One way to avoid delay claims is to develop a clear and realistic schedule. The contract must contain a realistic contract schedule (preferably one that has been reached by agreement prior to the start of work), a procedure for changing the schedule where necessary and an agreement for entitlement to time and compensation for changes to the schedule.

Poor structural design documents or uncoordinated drawings, which lead to RFIs, are a significant contributor to fabricator delays. The AISC *Code of Standard Practice*, discussed below, contains provisions, regarding design documents, that are clear and fair to both the fabricator and engineer who prepare the design. These provisions can provide protection for the fabricator for delays caused by bad drawings.

Subcontracts often contain "no damage for delay" clauses, which state that in the event of a delay, the fabricator may be allowed additional time but will not be allowed monetary compensation. These clauses should be avoided because they unfairly prevent a fabricator from recovering legitimate delay costs. No-damage-for-delay clauses are unenforceable in many states, but nevertheless should be removed from the subcontract if possible.

Liquidated damages clauses are also contained in many subcontracts. These clauses attempt to quantify or "liquidate," in advance, the amount a party will be required to pay if it breaches a contractual obligation. In the case of delays, these liquidated damages clauses can require the fabricator to pay a fixed amount per day or per week for delays caused by the fabricator. A liquidated damage provision should be closely scrutinized to make sure that it is fair and that the liquidated damages realistically approximate the amount of damages that are being incurred for delays. A fabricator should not be liable for liquidated damages if the delay experienced is concurrent or caused by a factor beyond the fabricator's control. Liquidated damages provisions may be unenforceable if they do not reasonably approximate the damages that would be anticipated at the time of contracting, or if they are deemed to be punitive.

Indemnification and Limitation of Liability

Indemnification clauses are clauses that require one party to defend and indemnify another party for claims made against that party. The scope of an indemnification clause should be closely scrutinized to assure that the indemnifying party is only indemnifying for claims arising from the indemnifying party's own conduct. In other words, the indemnifying party should not be required to indemnify another party from claims arising from either that party's negligence or some other party's negligence over which the indemnifying party has no control.

Many contracts contain clauses where a fabricator is required to indemnify a general contractor for all claims arising from the work, even if those claims are caused in part by the contractor's own negligence. These types of indemnification clauses should be avoided because the fabricator should not be required to indemnify the general contractor for its own or even partial negligence. While indemnity clauses relating to the general contractor's sole negligence are outlawed in many states under state anti-indemnity statutes, many states still allow parties to agree to pay for another's partial negligence and, therefore, these clauses should be modified. Additionally, the risk assumed by these clauses may not be covered by the fabricator's commercial general liability insurance policy.

An indemnification clause should only require a fabricator to indemnify the general contractor for claims *arising out of* the fabricator's work and only *to the extent of* the fabricator's negligence or breach of contract.

Also, limitation of liability clauses should be closely scrutinized. Limitation of liability clauses include such things as an overall liability cap, a cap on liquidated damages, exclusive remedy provisions (i.e., repair and replace defective work is "exclusive remedy" for breach of warranty) and waiver of consequential damages. Limitation of liability provisions may be beneficial to the parties; however, they should not be so onerous that they prevent one party from recovering legitimate out-of-pocket costs caused by the other party.

Incorporating the Code

The current edition of the AISC *Code of Standard Practice* should always be incorporated by reference in your contract. The *Code* represents the best practices for design, purchase, fabrication and erection of structural steel. By incorporating these provisions, the parties shall be required to follow the best industry practices for steel construction.

There are several specific provisions of the *Code* that are important to have in your contract. For example, Section 3 of the *Code* addresses design documents and specifications. This section provides the standards for structural design documents and specifications and identifies the information that must be contained on the design documents. It also provides procedures for connection design. The intent of the section is to ensure that fabricators are provided with complete design information necessary to detail and fabricate the steel members. Section 4 of the *Code* describes the responsibilities of the owner and fabricator for the development of fabrication and erection documents. The section requires that the owner furnish, in a timely manner, complete structural design documents and specifications that have been released for construction. The section emphasizes that designs should not be continuously revised after they have been released for construction. Section 6 of the *Code* describes the requirements for shop fabrication and delivery.

Because the *Code* provisions are intended to represent the best practices for the parties who are involved in the design, purchase, fabrication and erection of structural steel, it is important for them to be incorporated into your contract.

In summary, it is imperative to spend the time and effort at the beginning of the project to negotiate a fair and reasonable contract. Your ability to eliminate or mitigate "bet the company" contract clauses will pay dividends during the project and when a dispute arises. ■

This article is a preview of Session L1 "Bet the Company Contract Clauses and how to Avoid them" at NASCC: The Steel Conference, taking place March 22–24 in San Antonio. Learn more about the conference at ***www.aisc.org/nascc****.*