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Construction's Complexity

Traditional standard contracts can be a minefield for the unwary practitioner.

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In 2005, your law firm was asked by a client to draft the design-build construction agreement for a new professional football stadium. A brief consultation with your partners in the real estate department revealed that no partner had ever drafted or negotiated that kind of a contract.

In most projects, an architect and engineers are retained to prepare detailed drawings to be bid out by separate teams of contractors who desire to build the project. A design-build contract uses one entity that includes both the architect/engineer and the contractor, who provide a complete bid for the work.

The stadium contract, drafted for your client, mirrored a form, based on a standard agreement issued by the American Institute of Architects, that was used three years earlier for another client's large office tower. Modifications by the legal team for the design-builder called for an $800 million guaranteed maximum price agreement for the stadium.

Before execution, the design-builder's lawyers revised the 125-page agreement to include an exhibit called "exclusions and allowances." This 60-page exhibit set out a list of specifications for the stadium and adjacent parking lot that were awaiting prices for elements of the design, such as steel, concrete, and lighting, all of which awaited completion of the architect's and engineer's drawings.

Seven months later, the design-builder advised your client that the new cost of the project would be $962 million, not $800 million. In early 2007 your client learned that the final cost would be $1.4 billion.

Now your client is demanding a meeting with your partners to ask what protections you had included in the original agreement against such "outrageous cost increases," and whether there is any recourse to avoid paying $600 million above the price set out in the original agreement.

What do you say to the client when he—and you—discover that the so-called guaranteed maximum price was, based on the terms of the revised AIA contract, only a starting point and that the construction team's understanding was that you and your client knew this was the industry standard for large projects? How do you explain that you never realized the import of "exclusions and allowances"—or that they would lead to dramatic cost increases not a part of the so-called guaranteed price contract?

New Realities

Today's construction projects require sophisticated agreements with provisions that advance far beyond the standard form agreements traditionally used by most law firms, developers, and corporate and institutional owners. There are four reasons for this.

First, the manner and means by which today's complex projects are designed and constructed are no longer fully reflected in the traditional standard form industry agreements.

Second, construction projects, including school buildings, hotels, office towers, hospitals, and shopping complexes, now involve teams of specialized, highly talented design and construction professionals who must coordinate their efforts or cause the owner to incur untold delays and cost overruns.

Third, the complexity of many projects is reflected in the rising costs of products imported from across the globe, often involving hundreds of millions of dollars and sometimes billions.

Fourth, and perhaps most significant for lawyers asked to draft these agreements for owners, as costs have risen, it has become more imperative than ever to seek to properly allocate risk among team members and recognize that the owner bears a disproportionate risk.

As a result, the modern construction process makes it ill-advised—and some would even say an act of malpractice—for lawyers to use standardized form agreements for any but the most simple project. Faced with complex new design and construction issues, lawyers must now draft

agreements that recognize a myriad of issues never previously addressed. These issues include, among others:

- The diverse and increasing number of governmental and community agencies requiring team members to resolve often-conflicting codes, rules, and regulations or face the prospect of costly delays.
- The growing use of new products and building systems from abroad that can, if not adequately provided for in the contracts, result in shipping and customs delays at security-conscious ports.
- Provisions to preclude the improper use of contingency funds by construction managers and the unwarranted invoicing of the owner for duplicative general conditions, such as overhead, insurance, and related line-item costs, that can add millions of dollars to a project budget.
- Provisions designed to ensure post-9/11 security protections from the outset of the design phase.
- Developing a host of new insurance coverages that protect against such risks as hazardous environmental materials found on-site, collapse of buildings undergoing renovation or repair, insufficient coverage for design team members, and property damage during the construction process that can be insured by builder's risk coverage.
- Drafting provisions that reflect the increasing use of evolving technologies—such as software programs that incorporate design, fabrication, installation, and post-occupancy operational information on the design documents—which require enhanced coordination among project team members.

While it may be tempting for those who do not regularly prepare construction agreements to resort to standardized AIA industry forms, blind reliance upon such forms poses substantial hazards. Consider the example at the outset of this article. Many attorneys and lawyers do not know that a guaranteed maximum price contract is generally based on pricings of contractors that do not reflect complete and coordinated design documents, so many of the most important business terms of a construction contract may not be properly addressed from the owner's standpoint.

Lawyers must also be alert to the fact that prepackaged contract forms, promulgated by associations for architects, engineers, and the construction industry, require an owner to either create a new contract or adapt the industry forms with riders that often fail to address the inherent weaknesses in form contracts.

Even today's seemingly simple construction projects are far more complex than those built as recently as 10 years ago. Owners are facing increasing choices in the means and methods of design and construction. Counsel who blindly accept the preference of contractors for a "fast track" method of construction without a detailed understanding of its drawbacks will consistently expose clients to cost overruns of untold magnitude. Even the question of whether to use a construction manager or a design-build mechanism, for example, should give the most sophisticated executives pause.

The reality is that these standard forms have certain inherent flaws. For one thing, no owner group is consulted with respect to the issuance of these forms. But, at the same time, no AIA form can be issued until it has been reviewed and signed off by, of all things, the Association of General Contractors, the most prominent national trade organization for the construction industry!

As a result, numerous pro-claim provisions (provisions that protect the interests of the design professional and contractor and are adverse to the interests of an owner), which make it possible for the construction team to assert costly claims against the owner, are manifest throughout these AIA forms. They do little to protect the interest of the party that is most at risk—the owner who has paid for or leased the property to be developed, secured the funding for construction, and bears the risk of all uncertainties.

Counsel must recognize that each project is unique in that the variables—the special features needed to meet an owner's business goals for the project, the combination of consultants to be integrated and coordinated, and the phased completion dates for separate stages of many projects—all must be properly defined so that responsibilities and liabilities are properly ascribed to each of the project team members.

At the outset of each project, construction counsel must meet with executives or senior officials of the client and survey their critical needs. By identifying these issues, counsel ensures that the owner will be provided a series of agreements that contain the requisite provisions affecting its business goals and that require each team member to buy into the owner's goals as a component of the work, labor, and services to be performed.

As a result of this effort, each of the contracts for the individual team members should include wording that includes a commitment to project goals with the following objectives:

- To define the program and scope of the project to accomplish the business objectives of the owner;
- To design [or construct] the project such that it will result in an enthusiastic response from each of the different user groups who occupy the project as defined in the construction agreements;
- To meet all schedule and milestone constraints established by the owner as set forth in the project schedule;
- To incorporate the owner's marketing strategies and initiatives into those elements of the project that must complement and assist such strategies and initiatives; and
- To design [or construct] the project in conformity with the project budget established by the owner.

The High Cost of Inefficiency

A separate issue for counsel to address is the need to minimize cost overruns and delay claims that plague owners. The construction industry is the last "mom and pop" industry in America. Protected by a tradition of contracts that insulates it from the costs of its own mistakes, the industry has resisted innovation and undertakes each project as the result of a series of low bids that encourage inflated claims to ensure a profit at the end of a project.

Construction is highly inefficient. A recent study of worker performance reveals that almost 50 percent of all labor costs on a project are wasted due to late deliveries, waiting around to go up and down hoists, or gaining access to the site while delays from slow-moving subcontractors hold up the project. Even a 10 percent improvement in efficiency would result in savings to our economy of more than $120 billion a year.

Counsel who are not fully conversant with the many ways in which contractor inefficiency can drive up costs should retain an experienced owner's representative team to work closely in the review of bids and the preparation of the construction contracts.

Paradigm Shift

Is there any way that lawyers can serve clients by ensuring they won't waste tens of millions more on each project amid the forthcoming surge in construction spending?

In fact, we can contain construction costs. We can make immediate, practical, and elemental changes in the way America's construction industry does business. Here are several recommendations that will change the structure of the construction agreements we draft and rebalance the risks and priorities to more fairly reflect the interests of the owners we serve.

- Avoid the temptation of using "fast track" methods of construction. Although marketed by construction managers as a means of getting the project started months earlier (while waiting for the architect and engineers to finalize the design documents) this method has a poor history of completing early and almost always ensures that the budget will be exceeded by costs that dwarf any conceivable savings.
- Require the architect and engineers to provide 100 percent complete and coordinated construction documents at the time of bid to secure a fixed price bid from the construction team. Failure to secure this complete set prior to bid enables the contractor to add on costly change orders, drive up the contract price, and lead to further delay claims.
- Advise all team members that the goal is to secure a fixed-price contract for construction that may not be exceeded except for approved scope additions during the project. Require the contractors to identify any errors or omissions in the drawings during the bid process to avoid claims for such items during the project.
- Establish a fixed cost for contractor profit and overhead. Exclude additional overhead for change-order work that does not require additional supervision covered by the contract's general conditions.
- Preclude the contractor from holding the project hostage, such as stopping work on the entire project because of a dispute over the cost of a change order. Provisions should be inserted that require the contractor to proceed with disputed change order work and provide resolution via one-day arbitration to determine the final cost for this work.

Sophisticated legal professionals should recognize that construction law has become as sophisticated in its own way as bankruptcy, customs, intellectual property, and securities law. Lawyers who cavalierly enter into the task of drafting design and construction agreements or fall back on the use of AIA forms need to be well-versed in the nuances of construction and the complexities of how the diverse parties to a project work. Drafter beware! This is no longer a field for the lawyer to blithely enter—it is a minefield for the unwary practitioner.

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