AGC Law in Brief

Sponsored by

Pepper Hamilton LLP Attorneys at Law

SMITHCURRIE CONSTRUCTION & GOVERNMENT CONTRACT LAW SMITH, CURRIE & HANCOCK LLP

P&A Peckar & Abramson, P.C.

Practical Construction Law & Risk Issues

Older Newsletters

Volume 3, Issue 5
October 2017

The Interplay of Builder's Risk and Commercial General Liability Coverage

Kirk D. Johnston, Partner, Smith, Currie & Hancock LLP

ConsensusDocs 200, Standard Agreement Between Owner and Constructor, requires the contractor to purchase both commercial general liability insurance (§ 10.2) and builder's risk insurance (§ 10.3). When accidental losses, damages, or destruction of property occur during the course of construction, coverage may be afforded under both the commercial general liability (CGL) policy and the builder's risk policy. When both policies are potentially triggered, which policy should respond and in what order? This article discusses coverage under CGL and builder's risk policies, their interplay, and explores best practices in managing casualty during construction when both policies are potentially triggered.

Commercial General Liability

Commercial general liability insurance protects the insured party from injuries it may cause to other people or property. Accordingly, a CGL policy is "third-party insurance" in that it protects the insured from claims made against the insured by other parties who have suffered loss or damage for which the insured is responsible. ConsensusDocs 200 requires the contractor's CGL policy to include coverage for liability arising from premises, operations, independent contractors, products-completed operations, personal injury and advertising injury, contractual liability, and broad form property damage.

To comprehend the actual coverage afforded under the standard CGL policy form, the reader must conduct a three-prong analysis: (1) is the insuring agreement triggered; (2) if yes, does an exclusion or condition apply, and (3) if an exclusion applies is there an exception to the exclusion? To accomplish the above three steps, the policy reader must analyze the meaning of multiple words and phrases such as "occurrence", "accident", "property damage", "bodily injury", "your work", "expected or intended", etc.

Insuring Agreement

Coverage under a CGL can be written on either an occurrence or a claims-made form, but the occurrence form is preferred and used most of the time. The most commonly used occurrence form is the CG 00 01 published by the Insurance Services Office (ISO.

The insuring agreement of the CGL policy spells out specifically what the policy covers. The insuring agreement is broken-down into five subparagraphs (a. through e.) and includes six defined terms (bodily injury, property damage, suit, occurrence, employee, and coverage territory) and various specific limitations/requirements, all of which act to limit the coverage initially provided.

In simple terms, the insuring agreement provides coverage for the insured's legal liability arising out of bodily injury and tangible property damage for an occurrence during the policy period. An occurrence is defined as an "accident" which includes continuous or repeated exposure to the same general harmful condition. Under a "claims-made" policy, the insuring agreement is not triggered by an occurrence, but is triggered by a claim asserted against the insured during the policy period.

Exclusions

While the insuring agreement under any policy form is drafted in a broad manner, the scope of coverage under all policies is then narrowed by "exclusions" and "definitions". The CGL policy as authored by ISO has attempted to limit coverage for damage arising out of construction defects. Accordingly, during construction most damage occurring will not likely be covered because of the exclusions within the policy that embody the well-established business risk doctrine. These business risk exclusions are designed to exclude coverage for defective workmanship by the contractor causing damage to the work itself. The principle behind the business risk exclusions is based upon the distinction made between the two kinds of risk incurred by a contractor.

The first kind of business risk borne by the contractor is the risk of having to replace or repair defective work to make the building or project conform to the agreed contractual requirements. In the presence of the business risk exclusions, it is clear that this type of risk is not covered by the CGL policy. The second risk incurred by a contractor is the risk that defective or faulty workmanship may cause injury to people or damage to other property. As the liability associated with this risk is potentially limitless, it is the type for which the CGL coverage is contemplated. Below is a brief summary of relevant business risk exclusions and other exclusions which tend to limit coverage during the course of construction.

Damage to Product (exclusion k.)

The "your product" exclusion eliminates coverage for property damage to the insured's own products (not real property), which may include the insured's materials and supplies. Stated differently, this exclusion is designed to exclude coverage for damage to an insured's product arising out of a defect with that product.

Damage to Your Work (exclusion l.)

Perhaps the most hotly contested exclusion is the exclusion for damage to "your work". This exclusion performs the lion's share of the labor in eliminating coverage for losses arising from a contractor's poor workmanship in a completed operations context. The "your work" exclusion essentially excludes coverage for property damage to the insured's work after it has been completed where the damage arises out of the work itself. By specific exception, the exclusion does not apply if the work that is damaged or that causes the damage was done on behalf of the insured by a subcontractor.

Damage to Property (exclusion j.(1), j.(5) and j.(6))

Exclusion j.(1) is commonly referred to as the “owned property” exclusion and eliminates from coverage property damage to all property owned by the insured.

Exclusion j.(5) eliminates from coverage property damage to that particular part of real property on which the insured (or the insured’s subcontractor) are performing operations if the damage arises out of the operations. The phrase “are performing operations” has a present-tense connotation; and those courts that have had the opportunity to address this exclusion have interpreted it to apply only to ongoing operations and not to completed operations. Because exclusion j.(5) is restricted to the damage to “that particular part” of the property that needs correction because of the defective work, j.(5) does not apply to consequential damage to other parts of the project which are not defective.

Exclusion j.(6) applies to faulty workmanship in order to restrict coverage on risks that are typically covered by business risk insurance. Specifically, exclusion j. (5) eliminates from coverage that particular part of property on which the insured (or the insured’s subcontractor) are performing operations if the damage arises out of the operations. Similar to exclusion j.(5), j.(6) is only applicable during construction, as it specifically excepts from the exclusion property damage included in the products completed operations hazard. However, unlike j.(5), exclusion j.(6) does not exclude the work that a subcontractor performs for the insured.

While the business risk exclusions are designed to limit coverage for defective workmanship by the contractor, coverage is available during the course of construction for certain property damage. Specifically, when defective work causes damage and resulting loss to other non-defective property, coverage may be afforded. Accordingly, both a CGL and a builder’s risk policy may be triggered to respond to loss during ongoing operations.

Builder’s Risk

Builder’s risk is a kind of property insurance, providing first-party coverage for fortuitous loss during the course of construction. It is often referred to as “course of construction” insurance because it usually only remains in effect during construction and expires when construction is completed and the project is first used or occupied.

Builder’s risk typically covers the building or structure under construction and materials, fixtures, supplies, machinery, tools, and the equipment to be used in the construction. It may also provide coverage for temporary structures, scaffolding, worksite trailers, landscaping, and excavation work. It also provides some coverage for work to be incorporated in the structure, but stored offsite. Coverage can be extended to include property of others to which the insured may be liable, and soft costs, loss of rents, and delayed opening costs.

Typically, either the owner or the general contractor is responsible for procuring the builder’s risk policy. ConsensusDocs 200 requires the contractor to obtain builder’s risk insurance, but § 10.3.3 provides for an owner election to make the purchase. Regardless of who is responsible for arranging the coverage, builder’s risk policies typically include as named insureds all project participants, including the project owners, contractors, subcontractors, and others involved in the project. This is because all such participants have an insurable interest in the construction project. As a general rule, however, suppliers of materials are not commonly named, nor are architects or engineers. Since an insurer cannot generally subrogate against its insured, the naming of all project participants on the policy protects the project participants by preventing the builder's risk insurer from attempting to subrogate against any project participant.

Insuring Agreement

Unlike the CGL policy, builder's risk policies are not standardized. While the Insurance Services Office does offer builder's risk forms, those forms are rarely used because they provide less coverage than most insurers' manuscript forms. Specifically, ISO's forms are limited to site-specific coverage, whereas broader coverage is typically required for a project, for example, coverage for materials and equipment in storage off site or while such property is in transit. No matter what form is used, almost all builder's risk policy forms provide coverage under one of two basic formats: "all-risk" or "named peril" coverage.

All-risk policies, the most common type used, insure against all risks of direct physical loss or damage to insured property except those risks that are specifically excluded. It is important to keep in mind, however, that the label "all-risk" is essentially a misnomer. All-risk policies are not "all loss" policies. All-risk policies contain express written exclusions and implied exceptions which have been developed by the courts over the years. A cause of loss that is not specifically mentioned but is nonetheless not covered under builder's risk is a loss that is non-fortuitous. To be covered a loss must be fortuitous, this is it must occur unexpectedly or without known cause. This requirement is referred to as the "fortuity doctrine" and protects insurers from having to pay for losses arising from undisclosed events that existed prior to coverage, as well as events caused by the same during the policy period. In short, in order to establish coverage under an all-risk policy, the insured must show that an insurable interest and the fortuitous loss of covered property.

In contrast, a named peril policy insures against direct physical loss or damage to covered property or to insured property where the loss is caused by any of the specifically named perils or causes of loss. The enumerated perils insured against typically include, among others, fire, lightning, windstorm, hail, explosion, riot, strikes, civil commotion, aircraft, vehicles, smoke, leakage form fire protection systems, vandalism, and malicious mischief.

Exclusions/Perils not Insured

In general the exclusion section to a builder's risk policy is divided into three sections, each having multiple subparts. The first part identifies causes of loss that directly or indirectly impacts the covered property. These losses are excluded regardless of any other cause or event contributing concurrently or in any sequence in a chain of events that contribute to the loss and are often referred to as the broad exclusions. This wording is intended to exclude coverage if a covered cause of loss contributed to the loss. However, each exception typically has exceptions to the chain of events conditions. Examples of excluded causes of loss under part one typically include: (1) ordinance or law, (2) earth movement, (3) government action, (4) nuclear hazard, (5) utility services, (6) war and military action, (7) water, i.e., flood or subsurface water, and (8) fungus, wet rot, dry rot and bacteria. ConsensusDocs 200, Sections 10.3.1.1 through 10.3.1.6, specifies a number of risks that are not to be excluded from coverage including flood, earth movement, and water damage.

Part two excludes coverage for loss or damage caused by or resulting from certain enumerated causes or events. Unlike part one, part two is typically silent as to concurrent causation and may be referred to as limited exclusions. Examples of excluded causes of loss under part two typically include: (1) delay, loss of use or loss of market, (2) agricultural smudging and industrial operations, (3) wear and tear, (4) rust, fungus and other hidden or latent defects, (5) settling or cracking, (6) mechanical breakdown, (7) explosion of steam boilers, (8) continuous water seepage, (9) freezing liquids, (10) dishonest acts, (11) voluntary parting, (12) rain, snow, ice or sleet, (13) Collapse, (14) pollution, and (15) neglect. ConsensusDocs 200 Section 10.3.1.1 requires coverage of collapse. Section 10.3.1.4 requires coverage of equipment breakdown, including mechanical breakdown, electrical injury to electrical devices, explosion of steam equipment, and damage to steam equipment caused by a condition within the equipment.

Finally, part three excludes coverage for loss or damage caused by or resulting from certain enumerated causes or events. However, if a covered cause of loss ensues, then the loss or damage caused by the covered cause of loss is covered. Examples of excluded causes of loss under part three typically include: (1) weather conditions, (2) acts or decisions of governmental body, (3) faulty design, specifications, workmanship, repair, construction, renovation, remodeling, grading, and compaction, (4) material used in construction, and (5) discharge of pollutants. ConsensusDocs 200 Section 10.3.1.1 requires coverage of perils of lightning, windstorm, and hail. Section 10.3.1.2 requires coverage of damage resulting from defective design, workmanship, or material.

Concurrent Causation

Losses on construction projects often arise from a combination of forces. Some builder's risk policies specifically exclude coverage in cases of multiple or concurrent causation. If the policies or exclusion do not address the issue of multiple causes, often the courts will be asked to decide this issue. The court decisions are divided on how to resolve the question of coverage in light of concurrent causation. At least one court has held that if at least one cause is not excluded, coverage exists.

Most courts, however, use the "efficient proximate cause rule" to resolve coverage issues involving the concurrence of covered and excluded perils. The efficient proximate cause rule applies when two or more identifiable causes contribute to a single property loss, at least one of them covered under the policy and at least one of them excluded under the policy. Under this approach, which is the prevailing rule in a majority of jurisdictions, if multiple concurrent causes exist, and if the dominant or predominant cause is a covered peril, then coverage exists for the entire loss, even though other concurrent causes are not covered under the policy. If the dominant or predominant cause is an excluded peril, coverage would not exist for the entire loss, even though other concurrent causes are covered by the policy.

Ensuing Loss

Ensuing loss provisions can appear vague and ambiguous as to their effect. However, many courts have found that the provisions are themselves clear and unambiguous. As one court noted, "[t]he ensuing loss clause may be confusing, but it is not ambiguous." *McDonald v. State Farm Fire & Cas. Co.*, 837 P.2d 1000, 1005 (Wash. 1992). Reasonably interpreted, the ensuing loss clause means that if one of the specified uncovered events takes place, any ensuing loss which is otherwise covered by the policy will remain covered. The uncovered event, itself, is never covered. As the exclusion for loss or damages caused by workmanship, repair, and construction, typically contains an ensuing loss provision, coverage for faulty workmanship may be extended under a builder's risk policy. For example, if certain defective work (excluded) caused a collapse or a fire (covered event), then coverage would be afforded.

Practical Pointer

If a loss occurs during construction for which coverage may be afforded under both the builder's risk and a CGL policy, certain steps can be taken to best maximize coverage and lessen the financial impact to the project and its participants.

Owner Procured or Project Specific Builder's Risk

If there is a payout by the builder's risk carrier, it could have a financial impact on future premiums. For that reason, a general contractor should first assess if exposure to additional premiums is applicable. As discussed above, builder's risk may be purchased by either the owner or the contractor. If the owner bought the builder's risk policy, there is no risk of financial impact in the form of increased premiums on the contractor. If the contractor bought the builder's risk, then question whether the policy is project-specific.

Builder's risk policies are usually project-specific, meaning they commonly cover only one project. If the builder's risk is project specific, then any loss history will stay with project and there is no financial impact to the contractor. Larger construction industry policyholders may buy "rolling" builder's risk coverage which provides coverage for all of the insured's projects under construction. If the contractor insured the project with a rolling builder's risk policy, then any loss history will remain with the policy and the contractor may see increased premiums. If there is exposure to increased premium, a contractor may want to explore having the loss adjusted under the CGL policy of a project participant that caused the subject loss, for example, a subcontractor.

Need for Quick Resolution

As discussed above, builder's risk provides first-party property coverage. If there is a covered event, the builder's risk carrier will typically issue payment in short order. Receiving insurance proceeds quickly is critical, especially if the contractor cannot front end the cost of repair.

Conversely, a CGL policy covers liability to third parties. When a CGL claim is made, the insured may dispute that they caused the loss or argue that other parties also contributed to the loss. The insured's carrier may opt to defend their insured as opposed to merely tendering a check to cover the insured's liability. Unless the insured clearly caused the subject loss, a payment by a CGL carrier will likely take much longer than a payment issued from the builder's risk carrier.

Under the terms of many construction contracts subcontractors are required to endorse their CGL policies to respond as the primary insurance for any loss arising out of the subcontractor's work. At the same time, most construction contracts contain a mutual waiver of subrogation. If builder's risk insurance pays for a loss, there will be no right of subrogation, regardless of the fact that subcontractor's policy was supposed to respond as primary. This is important if the builder's risk was procured by the contractor and is not project specific. In such a situation, the contractor will want to document any delay by the subcontractor's carrier in the resolution of the claim and that the right to subrogate should not be enforceable in the current situation. While subrogation may still be waived if a payment is made by the builder's risk carrier, the contractor has preserved arguments that the subcontractor should not be allowed to rely on the waiver of subrogation because of its breach for failing to insure for the loss on a primary basis.

Further complicating any preservation of subrogation rights is the fact that under most builder's risk policies all project participants are generally insured, thereby preventing a carrier from subrogating against their own insured. It is good practice to have all project participants with an interest in the project named as insureds; however, it will likely close off any right of subrogation, even if adjustment of the claim under the subcontractor's CGL is unreasonably delay.

Preserve Relationships

Even if the owner procured the builder's risk and there is no financial risk to the contractor for tendering the loss to builder's risk, any tender to builder's risk may upset the owner. Contractors who desire to maintain a positive relationship with the owner should familiarize themselves with the owner's policy before making a claim. Builder's risk policies differ. To know whether a potential claim is covered it is necessary to review the specific policy covering the project. If there is no coverage for a potential claim, there is no reason to tender the claim and risk negative relationships with the owner. That said, prior to abandoning a tender a full coverage analysis should be conducted by counsel.

In the end, each project is different and the coverage scenarios are endless. Prior to taking any action on either the builder's risk or CGL, a contractor should always consult coverage counsel or its insurance broker.

Smith, Currie & Hancock LLP is a national boutique law firm that has provided sophisticated legal advice and strategic counsel to our construction industry and government contractor clients for fifty years. We pride ourselves on staying current with the most recent trends in the law, whether it be recent court opinions, board decisions, agency regulations, current legislation, or other topics of interest. Smith Currie publishes a newsletter for the industry "Common Sense Contract Law" that is available on our website: **www.SmithCurrie.com**.

Back to Top

When Surety Bond Incorporates the Contract by Reference, Is the Contract's Arbitration Clause Also Incorporated? The Answer Varies by Jurisdiction.

Robert E. Heideck, Partner, Pepper Hamilton LLP
Stephen W. Kiefer, Associate, Pepper Hamilton LLP

Surety bonds commonly contain language broadly incorporating the principal's contract by reference. In the event the principal's contract contains a mandatory arbitration clause and the obligee makes a claim on the bond, the parties may face an immediate procedural dispute over the proper forum for the claim: Must the obligee sue the surety in court, or may it submit the claim to arbitration?

Recent cases from several jurisdictions have produced conflicting results. In fact, two federal courts recently reached opposite conclusions in cases involving the same contract language, the same obligee, and the same surety. *Compare Developers Sur. & Indem. Co. v. Carothers*

Constr., Inc., 2017 U.S. Dist. LEXIS 111021 (D.S.C. July 18, 2017) *with Developers Sur. & Indem. Co. v. Carothers Constr., Inc*., 2017 U.S. Dist. LEXIS 135948 (D. Kan. Aug. 24, 2017). A survey of the case law suggests that the outcome in a given case may turn on the jurisdiction involved and the precise language used in the arbitration clause.

The decision by the district court in South Carolina in *Developers Surety & Indemnity Co. v. Carothers Construction, Inc.* is illustrative of those cases resolving the issue in favor of arbitration. There, general contractor Carothers Construction, Inc. ("Carothers") made a claim on its subcontractor's bond and demanded arbitration against the surety. The surety, Developers Surety and Indemnity Company ("DSI"), opposed Carothers's demand for arbitration by filing a declaratory judgment action and seeking a declaration that the arbitration clause in Carothers's subcontract with DSI's principal did not bind DSI to arbitrate Carothers's claim against it.

The arbitration clause in the subcontract required arbitration of "all claims, disputes, and other matters in controversy between the Contractor and the Subcontractor arising out of or relating to this Subcontract." DSI argued that the arbitration clause had no application to the claim between it and Carothers because, by its own terms, the clause applied only to claims "between the Contractor and the Subcontractor," and DSI, as surety, was neither. DSI similarly argued that Carothers's claims fell beyond the scope of the arbitration clause because the claims arose out of *the bond*, whereas the arbitration clause expressly applied only to claims arising from or relating to *the subcontract*.

The district court in South Carolina rejected DSI's argument. Focusing on the latter half of the arbitration clause, the court found that Carothers's claim "arose out of the subcontract" because it was a claim to hold DSI responsible for a breach of the subcontract by DSI's principal. The court further found that DSI had guaranteed the performance of all of the subcontractor's obligations under the subcontract and had incorporated all of the subcontract's terms, including the agreement to arbitrate disputes. Reasoning that a bond is to be construed together with the agreement it incorporates in order to ascertain the parties' intent, and that a surety obligates itself under a bond to the same liability as its principal, the court concluded that the parties intended to submit disputes against DSI under the bond to arbitration.

A similar result obtained in *Developers Surety & Indemnity Co. v. Resurrection Baptist Church*. *See* 759 F. Supp.2d 665 (D. Md. 2010). The court in that case followed what it considered to be the majority rule that a surety is bound to arbitrate disputes related to its bond if the bond incorporates by reference a contract containing a mandatory arbitration provision. In support of this majority rule, the court cited cases from the First, Second, Fifth, Sixth, and Eleventh Circuits, which reached the same result. *Id*. at 669-70 (citing cases). Applicable Maryland state law might have compelled a different result, but the court found that the Federal Arbitration Act preempted Maryland law, as Maryland law was "hostil[e] to the enforcement of arbitration provisions incorporated by reference into other agreements."[1] *Id*. at 672 n.1. The court thus followed federal substantive law as reflected in the "majority rule."

The dispute between Carothers and DSI in the district court in Kansas resulted in the opposite outcome, with the court holding that DSI did not agree to arbitrate. That court accepted DSI's interpretation of the arbitration clause, holding that, even though DSI incorporated the subcontract and its arbitration clause by reference, the clause simply did not apply according to

[1] Indeed, the "hostile" Maryland law cited by the district court in *Resurrection Baptist Church* was cited with approval by the Maryland Court of Appeals when it reached the opposite conclusion in *Schneider Elec. Bldgs. Critical Sys. v. Western Sur. Co.*, discussed below. *See* 2017 Md. LEXIS 482 (Md. July 28, 2017).

its own terms. Strictly interpreting the language of the arbitration clause, the court found that it expressly applied only to "claims, disputes, and other matters in controversy *between the Contractor and the Subcontractor*." 2017 U.S. Dist. LEXIS 135948, at *14-16 (D. Kan. Aug. 24, 2017) (emphasis added). The claim between Carothers (contractor) and DSI (surety) thus did not fall within the scope of the clause, the court reasoned. The court distinguished the cases representing the supposed majority rule on the basis that none involved an arbitration clause that limited its scope to disputes between specified parties. Instead, the court followed cases from the Eighth Circuit, District of Columbia, and District of Hawaii, which it described as involving similar limiting language. *Id*. at 18-19.

The district court in Kansas buttressed its conclusion by noting that several provisions in the subcontract, including the section that contained the arbitration clause, referenced "subcontractor" and "surety" separately. The court interpreted these references as further evidence of the parties' intent that the arbitration clause be limited to claims between the contractor and subcontractor, to the exclusion of the surety. Finally, the court distinguished the decision reached by the district court in South Carolina in the companion claim between Carothers and DSI. The court "respectfully disagreed" with the South Carolina court's reasoning and found that Kansas law differed from South Carolina law concerning the extent of a surety's liability. It found that, under Kansas law, a surety does not obligate itself to perform all of its principal's obligations absent an express assumption of those obligations. Incorporation of a subcontract by reference thus did not result in an assumption of all of the principal's obligations under the subcontract (including the principal's obligation to arbitration) as a matter of Kansas law.

The Maryland Court of Appeals recently reached the same result as the district court in Kansas. *See Schneider Elec. Bldgs. Critical Sys. v. W. Sur. Co.*, 2017 Md. LEXIS 482 (Md. July 28, 2017). There, the subcontract between the obligee and the principal included an agreement to arbitrate all "disputes between Contractor and Subcontractor." The surety, Western Surety Company ("Western"), advanced the same argument that DSI had made, *i.e.* that the arbitration clause was limited to "disputes between Contractor and Subcontractor."

Applying Maryland law, the Maryland Court of Appeals agreed, finding that the arbitration agreement expressly applied only to disputes between contractor and subcontractor, and Western, as surety, was neither. The court further noted that other provisions within the incorporated contract clearly referred to surety separately from subcontractor. As such, it found that the agreement did not intend for "surety" and "subcontractor" to mean the same thing. Thus, the court held that the arbitration clause's reference to disputes with the subcontractor must not have been intended to include disputes with the surety. Finally, the court rejected the notion that a surety's obligation for the principal's performance includes the obligation to arbitrate claims. Rather, the court ruled that the surety agreed only to ensure the performance of the construction its principal agreed to complete, and not every other contractual provision incorporated by reference, such as the agreement to arbitrate disputes.

As the foregoing demonstrates, the issue of whether a surety will be bound by an arbitration clause in a contract that its bond incorporates by reference may depend on several factors, including the jurisdiction supplying the governing law and the precise language used in the arbitration clause. Given the variability of results, consider the following:

1. Wording of the arbitration clause matters. If the clause includes language referencing "disputes *between contractor and subcontractor* arising out of or related to the

subcontract," the ability to compel arbitration in a dispute with the surety will be less likely.

2. A choice of law clause could provide greater predictability on the ability to compel arbitration.

Pepper Hamilton's Construction Practice Group has an unparalleled record of resolving complex construction disputes and winning complex construction trials. Our litigation experience – and success – informs everything we do, including translating into better results in our contract drafting and project management. Our lawyers counsel clients on some of the biggest, most sophisticated construction projects in the world. With more than 20 lawyers – including 13 partners who all have multiple first-chair trial experience – and a national network of 13 offices, we have the depth and breadth to try cases of any complexity, anywhere at any time. For more information about Pepper's Construction Practice, visit www.constructlaw.com.

Back to Top

ConsensusDocs 10-Year Milestone Marks a Brighter Outlook for the A/E/C

Brian Perlberg, Esq., Executive Director, ConsensusDocs

ConsensusDocs is a unique coalition to publish best practice standard construction contract. This September 27th, ConsensusDocs will hit a 10-year milestone. The ConsensusDocs coalition is a first of its kind industry-wide effort to bring the A/E/C industry together to create standard construction contracts that create a better contractual foundation to build successfully. The original mission and current mission continues to be to optimize better project results with less transactional costs – namely claims, contingencies, litigation, and contentious contract negotiations.

Now there is a ten year-track record of success for projects utilizing ConsensusDocs contracts that experience less claims and litigation than other standard contract documents which are written. The key was getting way from the traditional perspective of a particular segment of the industry writing the contract to getting all the players perspective to better align all parties to reach project completion successfully. Project histories using ConsensusDocs contracts help demonstrate that there really is a better way to build. This contrasts an approach that creates contractual silos that attempt to legitimize itself from reams of reported court cases that keep getting longer. Today, with a growing construction economy that craves more construction labor, brings an accelerating subscriber base for ConsensusDocs contracts.

The milestones demonstrate a better path forward. ConsensusDocs offers a fundamental contractual difference that enables an Owner of construction project to be more active in construction decisions. At the end of the day, an Owner has the most to gain or lose in a project's success, so their default role for everything should not just be as a check-payer. Also, a principle tenant of the coalition effort is that fair contracts get better results. Moreover, contract documents should be written clearly to be understood and facilitated contract administration, not to obfuscate and litigate. Direct party communications can actually be positive to help reduce and mitigate claims, rather than create contractually silos.

One of the most difficult obstacles to effectuate change is to demonstrate a proven track record of success in traditionally slow moving industries that are reluctant to change. Construction and legal contract drafting both fit into that category. However, there are two compelling reasons to change and maybe third. The first is that our current system of flowing down contractual risk to the lowest and often weakest party in the contractual change has been proven to be broken – and therefore needs to be fixed. The best studies on the subject, including one from Construction Industry Institute (CII) conclude that unfair contract provisions raise prices and get poor project results. Secondly, even if our traditional contract standard were working well, that doesn't mean you competition isn't going to disrupt the current way of doing business and replace it with a more efficient way. Cleary, the industry is starting to change. Even if IPD is not the dominate project delivery method, most construction companies are trying to incorporate lean principles into their construction processes. Your contracts need to keep up with business processes. And lastly, today's construction market has vastly improved to the point that those "weaker" parties in the contractual change are getting stronger and are going to demand fairer contracts.

Conclusion

Even if you do not use a standard contract document whole cloth, updates to consensus standard contracts are extremely valuable to ensure your contractual practices are keeping up with today's industry. ConsensusDocs will continue to create new documents, guidebook comments, and updates to help move the entire industry forward in a way that benefits constructors, owners, and design professionals alike with better project results and less claims. In 10 years, ConsensusDocs has become a viable option with a track record of success. During the next 10 years, they should become the defaults standard for a better foundation to build.

Back to Top

Consent Agreements – A Trap for the Unwary

Levi W. Barrett, Senior Associate, Peckar & Abramson

More often than not, construction contracts contain language requiring the contractor to consent to the contract's assignment to the project's lender. The basic goal of such an agreement is to permit a lender to step into the owner's shoes if the owner defaults, and to provide the lender with a vehicle to intervene before the contractor terminates the construction contract. Savvy lenders, however, may also view consent agreements as an opportunity to negotiate a better deal with the contractor. Many contractors view consent agreements as an afterthought, something they must simply accept to turn-on the funding stream. However, consent agreements can, and should, be artfully negotiated to ensure proper alignment with the terms of the construction contract. Obviously, a project is troubled if the lender takes over, but if the consent agreement is faulty, the contractor can be left picking up the pieces.

If the owner does not include the form of consent agreement as part of the construction contract, the contractor should only agree to execute a "reasonable" consent agreement. Once the form becomes available, the contractor then has leverage to negotiate appropriate terms. Below are tips to help guide the negotiation process.

Don't Get Caught in the Gap Between the Owner and the Lender

Be aware of potential traps in the gray areas that exist between the consent agreement and the construction contract. For example, the lender may require the contractor to obtain the lender's written consent before amending or modifying the construction contract. If this term is accepted without qualification, the contractor could find itself in the unenviable position of having a change accepted by the owner, before it is approved by the lender. Unmitigated, this could lead to a situation where the owner demands performance, while the contractor is still waiting for the lender's decision. While most construction contracts will permit additional time and/or compensation for owner-caused delays (including delays in approving changes), the contractor could bear the risk of impacts caused by lender delays.

Where a consent agreement requires the lender to approve changes, the contractor should take special care to align its obligations to the lender with the terms of the construction contract. Specifically, the contractor should make sure that it will receive adjustments for any costs or delays encountered in complying with the consent agreement. This can be done either by requiring the owner to sign the consent agreement, acknowledging that the owner is bound to its terms as an amendment to the construction contract, or through a side agreement with the owner.

Don't Let the Lender Change the Payment Terms

The lender should not be permitted to re-write the deal terms if it takes over the project. For example, the consent agreement may seek to impose new or different terms or reduce contractor's entitlements to reimbursable costs. Be wary of any attempts by the lender to limit entitlement to payment or to create carve-outs to the construction contract. It should be made clear in the consent agreement that the construction contract will take priority over any conflicting term in the consent agreement. Further, nothing in the consent agreement should be permitted to increase the contractor's obligations, or decrease its benefits under the construction contract.

Don't Permit the Lender to Drag-Out the Project

Terms of a consent agreement may require the contractor to give the lender advance notice before stopping work or terminating. Lenders often want a period of time to decide whether to take-over a troubled project. While this, in and of itself, is not problematic, the timeframe should be limited and should not interfere with or delay the contractor's right to stop-work or terminate the construction contract.

One way to rein the lender in is to include a finite timeframe within which the lender must agree to proceed with the project. In order to encourage the owner to move quickly, the contractor may want to include a provision permitting it to recover any costs associated with its downtime, demobilization and/or remobilization. It should also be made clear that the contractor will receive an extension of the contract time in the event the lender elects to proceed.

Limit the Owner’s Right to Claim a Breach of the Construction Contract

In certain circumstances, the contractor’s compliance with the consent agreement could place it in breach of the construction contract. For example, if the lender requires the contractor to directly communicate defects in the work, default events, or claims, this may violate confidentiality provisions in the construction contract. Another example exists where a consent agreement permits the lender to take-over a project if the owner breaches the owner-lender agreement. Since the contractor is not a party to the owner-lender agreement, it could find itself caught between the owner and the lender unless there is a mechanism in the owner-contractor agreement permitting the lender to intercede. As noted above, in order to avoid potential mishaps, delays and confusion, the owner should be required to accept all of the terms of the consent agreement as an amendment to the construction contract and waive any claims it may have against the contractor which arise as a result of the contractor’s compliance with the consent agreement.

Consent agreements are often overlooked by contractors who are either too optimistic to believe that the project will result in an assignment to a lender, or believe that if a lender take-over occurs, the project is beyond repair. However, a properly negotiated consent agreement can help insulate the contractor from significant exposure. Long known for leadership and innovation in construction law, Peckar & Abramson's Results FirstSM approach extends to a broad array of legal services — all delivered with a commitment to efficiency, value and client service since 1978.Now, with more than 100 attorneys in eleven U.S. offices and affiliations around the globe, our capabilities extend farther and deeper than ever. Find Peckar & Abramson's newsletter here.

Back to Top

AGC’S Commentary on the AIA A201 Gen. Cond. Doc.

Once every 10 years, the AIA contract document program publishes a new AIA A201 General Conditions document; for the past 30 years, AGC has put out a commentary on the A201 to alert our members. This AGC-member-only commentary document can be accessed on AGC.org.

Back to Top