REAL ESTATE, TITLE INSURANCE & CONSTRUCTION LAW

Avoiding Construction Claims

Pay attention to these problem areas

By Robert C. Epstein

Construction projects are renowned for generating conflicts, disputes and claims. Conflict seems to be an inevitable part of construction.

But conflicts and disputes on construction projects—and the claims they generate—can be minimized by effective planning and proactive management. History teaches that, while the parties and projects may change, the areas of conflict and types of disputes do not. Knowing the areas where conflicts are likely to arise, and carefully planning to address them, can reduce claims and increase the prospects for a successful project.

Some of the areas that generate claims on construction projects are as follows.

One-Sided Contracts

Owner-drafted contracts frequently seek to protect the owner from all possible claims. Such contracts contain exculpatory language,

Epstein is a shareholder at Greenberg Traurig in Florham Park. He co-chairs the firm's national construction law practice.

waivers and limitations intended to bar virtually all claims by the contractor. The idea is to protect the owner from all foreseeable and unforeseeable risks by shifting responsibility for those risks to someone else.

One-sided contracts, however, may generate as many claims as they prevent.

Construction claims principally are caused by: (a) unforeseen or changed project conditions; (b) changes in the work; (c) late provision of drawings, access, permits, equipment or materials; (d) inadequate drawings or specifications;

and (e) interference in the work. When commencing construction, contractors justifiably expect that all necessary permits are in place, they will have access to the work, they will receive timely engineering and owner-supplied information, shop drawings will be promptly reviewed and unexpected conditions or changes will be fairly compensated. Where these expectations are not met, contractors often lose money on a project, prompting claims no matter what the contract provides. In a worst-case scenario, severe losses may force a contractor out of business, resulting in a failure

to complete the work and the attendant project delays, disruptions and increased costs.

Construction claims are better avoided through a fair allocation of project risks. The guiding principles are that risks should be allocated: (a) first, to the party who has direct control over the portion of the construction that creates the risk; (b) second, where no party has direct control, to the party who is best able to protect against an unexpected loss; and (c) where no party has any control, to the owner, who is the party that initiated the construction project and is the ultimate beneficiary of the results.

The Project Delivery System

The delivery system selected for a project, and the contract structure reflecting that system, can generate claims regarding such fundamental issues as scope, time, money and risk allocation.

The traditional single-prime contract for a fixed price between the owner and contractor is the most commonly used and best understood project delivery format. This type of contract, with a clear chain of command, removes all ambiguity regarding which party is responsible to manage the construction work and which is responsible for the design.

Driven by market forces, recent decades have seen the use of innovative project delivery systems and contract forms reflecting those systems. Design-build, construction management and fast-track delivery systems often provide economic benefits to the owner. An

owner may need an office building by April, a shopping center by June, or a school by September, necessitating an alternative delivery approach to meet the owner's needs. Innovative project delivery systems, however, often blur the traditional roles and responsibilities of parties on a construction project. Use of nontraditional project delivery systems increases the risk of misunderstandings and claims, particularly where the scope of work and compensation are changing continuously during the project. For these reasons, the contingencies involved in nontraditional construction approaches are greater than in the traditional single-prime contract approach.

The Design

An incomplete, inaccurate or poorly coordinated design inevitably will produce a project with conflicts, unanticipated costs, delays and claims. Conversely, nothing diminishes the risk of conflict, and provides more protection for the owner, more than an accurate and complete design.

To minimize claims, owners should take measures to assure that the project plans are as complete and error-free as possible, such as by having the plans peer-reviewed by independent designers and evaluated for constructability by a qualified contractor.

Site Conditions

Views differ on whether, and to what extent, a contract should provide additional compensation for differing site conditions. Some

form contracts (such as the federal and American Institute of Architects standard general conditions) include a "differing site conditions" clause which entitles the contractor to additional compensation for unexpected subsurface conditions meeting certain criteria. Some owners (public and private) model their contracts on these forms. Other owners utilize contracts that are silent on the issue, or expressly prohibit recovery for differing site conditions while placing all of the risk of the unknown on the contractor.

The assurance of equitable compensation for differing site conditions encourages prudent contractors to submit lower bids that do not include contingencies for unknown conditions. Just as importantly, a differing site conditions clause helps protect prudent contractors against being underbid by competitors who are either too careless or too reckless to include such a contingency. Because hidden conditions can make the difference between a profitable contract and a financial disaster, contractors often insist on an equitable adjustment clause before submitting a bid on a job with significant risk of differing site conditions.

Contractor Submittals

The shop drawing process seeks to avoid misunderstandings by allowing the contractor to demonstrate the detailed application of the architect's or engineer's design. The contractor reviews the shop drawings to coordinate the

trades and verify that the project can be built. The designer reviews the shop drawings to ensure that the proposed construction scheme meets the design intent for the completed structure.

The process of shop drawing submittal and review is intended to be a dialogue between the designer and builder concerning the details of construction. It is here that the owner, contractor and designer have the best opportunity to avoid claims due to nonconforming or defective work.

Proactive Claims Management

The prudent owner will keep a close eye on the progress of construction to head off conflicts and claims.

Owners commonly leave construction oversight to the construction manager and often have no knowledge of conflicts that are brewing in the field. Some of those conflicts eventually become claims. Many owners find that, by the time they become aware of a claim, the dispute is far more serious (and therefore more disruptive and costly to remedy) than it would have been had the issue been detected and properly managed earlier in the construction process.

Unfortunately, some owners, even on large projects, attempt to avoid overhead costs by cutting corners here. Even if an owner ultimately proves that the contrac-

tor made a bad pour or connected the steel improperly, it is infinitely better to discover the defect early rather than well into the construction stage, where claims usually are the result. By regularly reviewing construction activities using a variety of methods, an owner improves the chances of uncovering conflicts, reducing unexpected change orders, detecting potential design errors, revealing poor construction practices and avoiding claims.

One way the owner can review construction activities is by periodically reviewing project meeting minutes. Doing so improves the chances of detecting issues and conflicts before they ripen into claims. Although the construction manager is primarily responsible to oversee construction activities, occasional independent review by the owner improves the chances of recognizing conflicts early, particularly where the construction manager's own error may have caused or contributed to a problem.

The owner also can review construction activities by conducting periodic project audits intended to: (a) detect fraud, including contractor overbilling, inappropriate cost-shifting, abusive change-order practices and other abnormalities; and (b) verify contractor compliance with government requirements (e.g., prevailing wage, disadvantaged business enterprise).

Establish and Manage Owner's Document Repository

Owners should maintain their own document repository where important project documents are organized, maintained, managed and protected.

Major construction projects generate millions of documents and, as issues arise, owners need immediate access to pertinent documents. Many owners delegate document management to the construction manager, who maintains all construction documents on its own servers. This arrangement leaves the owner at a knowledge disadvantage, creates difficulties in accessing information quickly when needed, and makes claims more difficult and expensive to address. Owners should maintain their own document repository and not rely too heavily on the construction manager. Having immediate access to pertinent documents through its own repository, and establishing project protocols to ensure that all parties deliver certain project documents to the repository, is especially important to an owner in the event of disputes with the construction manager.

Construction projects are renowned for generating conflicts, disputes and claims. By proactively managing the project risks that are likely to generate disputes, owners can minimize claims and improve the chances for a successful project. ■