

CONTRACTS:

READING THE RED-FLAG CLAUSES

Read and understand these key clauses or proceed at your own peril

by Sam Starobin

How often back in school did we race to give the answer before fully reading the problem! We paid the price in grade points.

Well, we are older now and foolish things like not reading the problem are likely to cost us money. In this case, the problem is the construction contract and too many contractors accept work under contracts they really don't fully understand. When a contractual problem arises, they learn the contract the hard and costly way.

As a former government contracting officer who has administered hundreds of contracts, I have observed a scenario like the following all too often. Contractor X has completed his contract, added up all his costs, and to his great surprise and sorrow, found that he has lost money on the contract. What to do? He assembles his project superintendent and his engineer and reviews the job to see where he can squeeze out the money to make himself whole.

The project superintendent speaks up: "Remember when we started excavating? We bid on clean dirt but we ran into that trash and we had to overexcavate and bring in clean fill." "Great," says Contractor X, "that cost us a bundle. We'll write it up as a claim."

Then the project engineer chimes in. "Remember when we submitted those shop drawings for rebar? We were supposed to get them back in 15 days but it took 45 days and we had to hold up the job for a week because of it. That cost us money."

The group throws together stories for four or five such episodes, cooks up some costs (since they have kept no accurate records), adds up the total and breathes a sigh of relief. "We're saved. This makes up our loss."

When their claim finally reached my desk, I had a sad duty to perform. In spite of my sympathy for their situation, I could not expend public money on unsubstantiated claims. First, the contract set time limits for submitting claims for various causes, and missing these dates waives the right to compensation. Then the contractor must be able to substantiate his claim. It is not enough to have a legitimate claim; the contractor must be able to prove it with documentation.

In this article, I hope to help you avoid the problems faced by Contractor X. I assume you are working on fixed-price contracts. You are familiar with the General Agreement, the document you sign that sets out the price, the time,

and the product of the contract. You have studied the drawings, and read the specifications (I hope). But do you know the General Conditions, that section of dry legalese? This is where many contractors, like Contractor X, trip up.

Changes

"The Contracting Officer may, at any time, without notice to the sureties, by written order designated or indicated to be a change order, make any change in the work within the general scope of the contract. . . ."

*sample contract language from GSA Standard Form 23A

The General Conditions define the basic relationship of the parties and establish the procedures for dealing with various situations that arise in a project. The provisions of the General Conditions that deal with particularly troublesome areas such as changes, delays, differing site conditions, disputes, and suspension of work, have been called the "red flag clauses." It is vital that you understand these clauses. This article will discuss their content in four basic contract documents, the Federal (Standard Form 23A), the Massachusetts Division of Capital Planning and Operations, the American Institute of Architects (AIA), and the Engineer's Joint Contract Documents Committee (EJCDC), which is the one endorsed by the Association of General Contractors. These four should give you a basis for reading and interpreting other contract documents. The accompanying table shows where these clauses are found in the various contract forms.

The Red Flag Clauses

Changes. Changes are an inevitable part of the construction process and all contract forms establish rules for handling them. In general, they establish the right of the owner to direct changes within the general scope of the contract, and to require the contractor to perform them. The contractor is required to submit his request for adjustment of time and money in a reasonable time (within 30 days in the case of the Federal contract). A change request that is beyond the scope of the contract because of its size or scope may constitute a *cardinal change* and call for renegotiation of the contract.

The tricky part of the changes clauses has to do with the undeclared change,

the so-called "constructive change." Let's say you have submitted a shop drawing for a detail of the building structure. The shop drawing comes back with a note that additional structural members must be added in order for

case of disputes, the contractor may submit a claim under the disputes provisions of the contract, but must perform the work, unless he believes he has been faced with a cardinal change. If you think you are faced with a cardinal change, seek legal advice. This is a complex area of contract interpretation.

The owner, in general, absolves himself of the requirement to get the surety's permission to impose a change. The contractor must keep his surety informed of the magnitude of the change to insure his bonding will cover the project.

An important point: Your right to a change order does not depend on the financial status of your project. Like Contractor X, some contractors try to make up for losses by submitting a flurry of claims at the end of a project. This rarely works. If you have a right to a change, act on it, but at the proper time. Late may mean never!

RED FLAG CAUSES

	Federal Standard Form 23A	Massachusetts Div. of Capital Planning and Operations	American Institute of Architects (AIA)	Engineers Joint Contract Documents Committee (EJCDC)
CHANGES	GP3	ART VI	ART 12.1 ART 12.4	ART 10 ART 9.5 ART 11.2
DIFFERING SITE CONDITIONS	GP4	ART VI 5a	ART 12.2	ART 4.3.2 ART 4.2.3
DISPUTES	GP6	ART VI 3 ART VI 5b ART VI 5c	ART 2.2.9 ART 2.2.12 ART 7.4.1 ART 12.3 ART 7.9	ART 9.11 ART 9.12 ART 6.29 ART 16
SUSPENSION OF WORK	GP 17	ART V 3	ART 3.3 ART 14	ART 15
DELAY, TIME EXTENSION LIQUIDATED DAMAGES	GP 5	ART V 1c ART V 2c	ART 8.3	ART 12
EXCULPATORY	GP 10 GP 13	ART IV 7 ART V 3	ART 6.2.2	ART 4.3.1.1 ART 4.3.1.2

was to have been removed by others is still there and you must remove it to be able to start work. This too is a constructive change.

If the contractor feels a change has been imposed on him, he must serve notice on the owner in a timely manner (within 20 days in the Federal contract) citing the circumstance and requesting a change order. Failure to meet the reporting requirements may lose you the right to claim compensation. In the

Differing Site Conditions.

I'm sure you have been there. You start excavating in an area where the boring data promised easy digging and run into a rock outcropping. Or you start renovation of a building and find the piping badly corroded though the contract documents indicate good piping. What are your rights? What do you do to protect them?

All four contract documents used in

discussion make specific provision for adjusting the contract in such cases. All emphasize two requirements; timeliness and documentation. The owner must be notified as soon as possible after the differing site condition is discovered, the notification must be in writing, and any claim for adjustment of contract time or price must be submitted in a timely fashion.

Differing Site Conditions

"The Contractor shall promptly, and before such conditions are disturbed, notify the Contracting Officer in writing of: (1) Subsurface or latent physical conditions at the site differing materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual nature, differing materially from those ordinarily encountered..."

GSA Standard Form 23A

The Federal and EJCDC contract forms are more specific. They require the contractor to inform the owner in writing as soon as the condition is discovered. Further, he must not modify those conditions until the owner has had a chance to examine them and determine whether a contract modification is justified. If you change the condition before the owner can observe it, you may lose your right for compensation. In any case, do all you can to document the case. Take lots of photographs. Good documentation will help you establish your case with the owner, or in a disputes procedure if it comes to

that.

Disputes. Construction is a field that provides plenty of opportunity for disagreement. If you are fortunate in having a reasonable owner to deal with, and if you have worked to establish an atmosphere of cooperation, most disagreements will be resolved by negotiation. For those that are not, the contract documents provide for a dispute mechanism.

The decision to trigger the disputes mechanism is up to you. The four contract documents used here vary in details but agree in substance. If you feel your attempts to resolve a disagreement have come to a dead end, you must then submit your claim in writing to the owner or his designated agent. He must respond with a decision in writing within a set time. This decision is final, unless you decide to appeal the decision to a higher level. In the Federal system, this higher level is generally a Contracts Review Board. Under the Massachusetts contract, it is a hearing officer for small disputes and the court system for

Disputes

"Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer..."

GSA Standard Form 23A

larger. The AIA and EJCDC contract forms call for arbitration.

If you have come to this step, remember that documentation is the key to success. Obtaining justice depends not only on being in the right, it depends even more on being able to prove it.

Suspension of Work. The owner has decided on a change in the structure and you have been given an order to suspend work until the redesign is accomplished. Or, you have submitted shop drawings for the next phase of work. They have not been returned and you can't proceed. In either case, there you sit, the money meter running and unable to move. Can they do this to you and what are your rights?

All the contract documents authorize the owner to suspend work for various reasons but they provide for compensation for suspensions beyond a certain length. The Federal clause states compensation may be claimed for an unreasonable period of delay, whatever that is. Massachusetts is more specific. You can claim compensation for delays beyond 15 days.

does not remove the threat of financial penalties. There is always the possibility of actual damages being assessed against you.

What protections do you have! All four contract forms recognize the possibility of excusable delay. In general, acts beyond your control may constitute such a delay: strikes, floods, unusually severe weather, acts of God, etc. The important thing in claiming a time extension for such a cause is timeliness. The claim must be submitted soon (10 days in the Federal contract) after the start of the delay.

Exculpatory Clauses. This is a fancy word that means the owner shrugs off responsibility for certain situations. A typical exculpatory clause is one that denies the contractor either time extensions or additional compensation regardless of the cause. The contract documents discussed here have no significant clauses of this type since they were drafted with a view to fairness. Many private owners, however, have no such concern for fairness, and strengthen their position with exculpatory clauses. Watch for them and consult with your

Suspension of Work

"The Contracting Officer may order the Contractor in writing to suspend, delay, or interrupt all or any part of the work for such period of time as he may determine to be appropriate..."

GSA Standard Form 23A

You may be forced into a work suspension by an act or failure to act on the part of the owner. This constitutes a constructive suspension. Since the owner has not explicitly directed a suspension, you must inform him that his action or failure to take action has forced you into a suspension. Do this, in writing, as soon as possible. Both the Federal and the Massachusetts contract forms state the contractor must submit this written justification within 20 days after the act or failure to act that caused the delay. Claims for damage due to the delay must be submitted as soon as possible after the end of the delay.

Delays, Time Extensions, Liquidated Damages. Have you ever over-

laid a lawyer as to their validity. Exculpatory clauses have not always held up in court, but you are never sure. Don't let them sneak up on you unawares.

This discussion should provide an introductory guide to understanding your contractual position. Contracting is a tough game. It is hard enough to be successful when you know the rules; it may be impossible if you don't. If you are dealing with an unfamiliar contract, make sure you understand the General Conditions. Get a lawyer to help if you have trouble plowing through the legal verbiage. The time and money spent may save you considerably more time and money later and you will sleep much better. ■

Delays

"The contractor's right to proceed shall not be so terminated nor the contractor charged with resulting damage if:

(1) The delay in the completion of the work arises from unforeseeable causes beyond the control and without the fault or negligence of the contractor, including but not restricted to, acts of God, acts of the public enemy, acts of the Government..."

GSA Standard Form 23A

run the contract time? You are a rare contractor if you haven't. Overrunning the set completion date exposes you to financial penalties. Both the Federal and Massachusetts contract forms specify liquidated damage as a penalty for overruns. However, the absence of a specified amount for liquidated damages

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