Negotiating Contract Clauses To Avoid The Reality Of Litigation

By David Kiefer

No construction contract is perfect, partly because the parties cannot always anticipate what aspects of the project will experience problems at the time they are negotiating the terms of the agreement. There are a number of clauses that are commonly found in construction contracts, however, that can be negotiated and structured in a way to avoid claims by contractors and prevent problems for Owners in the event disputes arise. These include notice of claims provisions, waiver of damages, language related to differing site conditions and dispute resolution clauses. An ounce of prevention during the negotiation of these contract terms can avert pounds of litigation at the end of the project.

Not All Notice Provisions Are The Same

Virtually every contract for construction services has some sort of provision that requires a contractor to provide the Owner with written notice of a claim within a certain time after it arises. In fact, the failure of a contractor to provide proper notice is typically an Owner's first line of defense in a dispute proceeding. This defense can be an effective one, especially if the contract is governed by a jurisdiction such as New York, which has historically required rigid compliance with notice provisions by contractors before they can successfully pursue a claim in court.

However, Owners should be aware that a recent decision from a federal court in New York has suggested that not all notice provisions are created equal. In the case of American Manufacturers Mut. Ins. Co. v. Payton Lane Nursing Home, Inc., 2010 U.S. Dist. LEXIS 1706 (E.D.N.Y. Jan. 11, 2010), the court drew a sharp distinction between contract provisions that set forth the consequences of failing to provide notice and those that merely call for notice of claims but do not expressly state that the claim will be waived if the provision is not strictly complied with. Examining the line of cases that came before it on this issue, the court suggested that only those provisions that expressly state the consequences of failing to comply with the notice requirements justify the court barring a contractor's claim.

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Owners can avoid this type of scrutiny from a court by using contract language that makes clear to a contractor that it will waive its claim if the requirements for notice are not strictly complied with. More specifically, the notice provision should not merely set forth the requirements for how and when the

notice is to be given, but include language such as: "Failure to strictly comply with the requirements of this provision shall result in the waiver of the claim." This should ensure that a notice defense in a dispute proceeding at least gets past the first step towards successful application.

Watch What You're Waiving

Construction contracts often have a number of provisions that limit the types and amounts of damages the parties can seek in a lawsuit. They may limit recovery to liquidated damages, bar delay damages and waive consequential damages. The details of these clauses matter and when a dispute arises, a party to a contract may find that it waived more than it wanted to.

Owners should also be careful to not assume and represent that the information it is providing accurately depicts the actual conditions for the project, especially if the information is dated.

For example, when most attorneys think of the term "consequential damages" they think of damages such as lost profits. The types of damages that are being waived under the rubric of consequential damages, however, can be expanded by such clause in the contract to include direct damages as well. The clause might state that the consequential damages that are waived include the increased cost of operations and maintenance.

Such a provision can pose a real problem for an Owner who is seeking to recover the increased cost of operations it has incurred due to defective equipment that is not operating as efficiently as it should be. In order to avoid this situation, Owners should take a quick look at any waiver of damages and make sure that it does not bar the recover of any particular costs that the Owner would likely incur as a direct result of the contractor's shortfall in performance.

Conversely, the Owner should try to negotiate to include a bar on a contractor's indirect damages, such as inefficiency costs due to "cumulative impacts." Contracts and change orders do not always specifically bar damages due to "cumulative impacts," which arise when a contractor experiences impacts to unchanged work due to the inefficiency created by the large amount of changes to the overall project.

On a large project, these costs can be exurbanite and typically pop up at the end of a project even if the Owner has already paid for the contractor's direct costs pursuant to executed change orders. Moreover, at least one court has questioned whether a bar on "indirect costs" covers cumulative impacts damages. *See Bell BCI Co. v. United State,* 72 Fed. Cl. 164 (2006) (noting that the term "indirect costs" can refer to overhead or administrative expenses that must be allocated among multiple projects as opposed to inefficiency costs on a particular project). Therefore, Owners should attempt to have cumulative impact and inefficiency costs expressly waived by the contractor in the base contract and in any change orders for extra work, if at all possible.

Properly Disclosing Site Conditions

It is prudent practice for the Owner of a construction project to disclose all the information it has on the project's site conditions at the time contractors bid on the project. If the Owner has relevant information about site conditions that it withholds from its contractor and the condition turns out to be different than the contractor anticipated, the Owner could be liable for the resulting extra costs.

How the information is disclosed can also influence whether an Owner is ultimately liable for a differing site condition claim. In the New York case of Grow Construction Co., Inc. v. State, 391 N.Y.S.2d 726 (3d Dep't 1977), the court found that even though the Owner disclosed relevant information regarding soil borings, its failed to put them in a place in the contract that would have led the contractor to believe that the conditions were predominant factors, instead of incidental ones. Therefore, Owners should put all pre-bid information in conspicuous and logically relevant areas of the bid documents.

Owners should also be careful to not assume and represent that the information it is providing accurately depicts the actual conditions for the project, especially if the information is dated. Specifically, the contract should note that the Owner does not warrant that the information accurately depicts the actual conditions and is just providing the information for the contractor to use as it sees fit.

Moreover, Owners should include a clause that requires the contractor to conduct its own site investigation and indicates that the contractor agrees not to bring a claim if the actual conditions are different than those depicted in the information provided by the Owner. See Sasso Contracting Co. v. State, 173 N.J. Super. 486 (App. Div. 1980) (distinguishing "general exculpatory clauses" that do not shift the burden of subsurface conditions to the contractor and contract language that is "straightforward, unambiguous and categorical" in its requirement that the contractor conduct investigation, disclaimer of Owner responsibility and waiver of claims).

Arbitration vs. Litigation

Construction contracts routinely have dispute resolution provisions that force the parties to arbitrate their disputes instead of litigating in courts. The rationale behind these clauses is that arbitration is a quicker, cheaper and more efficient way of resolving disputes. In reality, that is not always the case. Arbitrators are increasingly allowing broader discovery, including depositions and third-party subpoenas, making the discovery phase of the process resemble traditional litigation. By using arbitration instead of courts, parties will also forfeit their ability to utilize pre-trial motions to have claims that are not adequately supported by evidence dismissed before a full-blown trial.

Moreover, at arbitration hearings, evidence rules are relaxed such that arbitrators consider virtually all evidence presented. This can prolong the hearing and confuse the core issues in dispute. Conversely, when defending against a large, complex claim in litigation before a court, an Owner can use the rules of

evidence to exclude unreliable evidence and force the claimant to use competent evidence to support its claim.

In short, Owners should not just include a boilerplate arbitration clause in their contracts simply because that is what they have always done, but should first consider what types of claims they might face and how they would want to have them resolved. Arbitration is still the best option for straightforward claims that can be resolved without a lot of investigation into facts that are not readily available, but traditional litigation may be the best way to confront complex claims that will require extensive evidence.

Owners might consider a hybrid approach in which claims for money below a certain amount are handled through arbitration while the parties retain the option of handling claims above such amount through litigation. Finally, if arbitration is called for, the parties should provide as much detail as possible in the clause as to how they want the arbitration conducted (e.g., type and breadth of discovery, number of arbitrators, etc.).

Conclusion

In sum, Owners should take the time during the negotiation of a project to review and reconsider some of the terms and conditions in the contract that they may have always considered boilerplate. On the front end of a project, these clauses may seems mundane and unimportant but during a litigation or arbitration all terms of a contract will be repeatedly examined, parsed and argued over. Creating the strongest contract language possible is the best way to set the stage for a successful dispute resolution proceeding or, better yet, avoid one altogether. ●

David Kiefer is a partner at SNR Denton and has extensive experience representing Owners and contractors in construction disputes before state and federal courts and domestic and international arbitration tribunals. Kiefer has represented clients in litigation over hundreds of millions of dollars of claims related to large infrastructure projects, as well as clients involved with smaller claims related to community based construction projects.

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