Contracts
A Philosophy on Contracts

- If you can’t do a job on the basis of a handshake, you don’t want the job.
- Always back up the handshake with a water-tight explicit contract
Hammurabi’s Code

FROM THE CODE OF LAWS

HAMMURABI (2360 BC)
KING OF BABYLONIA
**Definitions**

- **Contract**: An agreement, usually between two parties, that is enforceable by law.
  - Unilateral – one side makes a promise, expecting performance from the other
  - Implied – terms not clearly stated
  - Written contract – terms specifically stated on paper
  - Verbal contract – spoken agreement
  - Estoppel – contract becomes binding in spite of the fact that no formal agreement has been made.
  - Entire vs. Severable – Partial compensation for partial performance
  - Subcontract – contract between one contract party and a third party to perform some part of primary contract
Elements of Contracts

- Offer and Acceptance (counteroffer)
- Meeting of the minds – parties agree at time of contract on basic meaning and implications
- Consideration – something of value
- Lawful subject matter
- A contract is executed when both parties have fully performed in accordance with the contract.
- Defaults and Remedies
  - Damages
  - Specific performance
  - Liens
Writing an effective contract

- The more explicit and detailed, the better
- Include physical, demonstrable deliverables
- Include deadlines as contract requirements
- Specifically address remedies for failure to perform
- Specifically address issues of severability
- Specifically address subcontract issues
- Specifically address confidentiality terms
- Specifically address bonding and insurance requirements
- Specifically address grievance procedure
- Get it checked by a contract lawyer
Project Structure

- Owner’s option, subject to procurement and other regulations
- Should provide incentives to meet owner’s objectives
- Determines owner’s level of control and oversight
Considerations in Project Structure

- Experience, involvement level of owner
- Objectives – cost, quality
- Relationship between owner and engineer/architect
- Preferences of engineer/architect
- Managing the interests of involved parties
Methods of Contracting

- Open Competitive Bidding
- Selected Competitive Bidding
- Negotiation
The Players

- Owner
- Engineer/Architect
- General Contractor
- Subcontractors
- Laborers
- Regulators
Architects and Engineers

- **Architect:** One whose occupation is the utilization of expertise in the formulation of designs, detailed plans, and specifications used by a contractor on the erection or alteration of a building. May include supervision of construction.

- **Professional Engineer:** A person engaged in the professional practice of rendering service or creative work requiring education, training, and experience in engineering sciences and the application of special knowledge of mathematical, physical, and engineering sciences in such professional or creative work as consultation, investigation, evaluation,
Traditional Contract Agreement
Separate Contracts Arrangement (Construction Project Management)
Design-Build

Owner

Engineer/Architect  Contractor

Worker  Worker

Subcontractor

Worker  Worker

Subcontractor

Worker  Worker
Outline:

- Introduction to Risk Management
- Bonds, purposes of bonds, and types of bonds
- Construction Insurance, its requirements and general insurance topics
- Construction safety and safety programs
Introduction to Risk Management

- Risk in the construction industry is highly unpredictable and extreme.
- In construction projects, risk is a major concern for the engineer, the contractor and the owner.
- Owners have instituted risk management concepts to preclude losses resulting from natural causes, accidents, and mismanagement.
- **Risk management** is a comprehensive approach to handling **exposures** to **loss**.
Introduction to Risk Management, cont.

• Exposure is the potential for liability and claims.

• Three ways to manage exposure:
  • Minimize exposure (not for construction projects)
  • Bonding and insurance
  • Make yourself an unattractive target for claims
• Three types of losses:
  • Losses from physical means can be minimized through construction insurance.
  • Losses from mismanagement can be minimized through specialty bonds.
  • Losses due to accidents can be minimized though the implementations of an intensive safety program.

• A recent example:
  • In Florida on May 7, 2006, a support frame collapsed at a high-rise construction project killing three workers who became trapped in quick-dying concrete. The workers were in the 27th level of the building pour its concrete roof.
A contract bond is a guarantee by contractors that they are financially capable of performing the work identified in the construction contract.

Three main types of contract bonds:
- Bid Bonds
- Performance Bonds
- Labor & Material Payment Bonds
Some definitions

- Principal: the party who is responsible to perform the undertaken being bonded, (usually the contractor).
- Surety: the party who is guaranteeing the performance of the principle, (the bonding company).
- Obligee: the party for whose benefit the bond is written (the owner).
- Surety Bond: the written document given by the surety and the principle to the obligee to guarantee a specific obligation.
- Indemnity Agreement: the contract between the principle and the surety (the principle guarantees the bonding company that no loss would happen due to providing the bond).
- Penal Amount: the face value of the guarantee, usually 100% of the contract amount.
- Claimant: the party who is filing a claim against the bond to recover expenses or costs due to nonperformance of the principal.
- Lien: the legal right of a party to control the property of another or have it sold in order to recover payments of a claim by the injured party.
Purposes and advantages of bonds

- Bonds are used to guarantee completion of a project as specified and that it will be free of liens when completed.

- Main advantages of bonds:
  - The owner is protected against the withdrawal of a favorable bid by a contractor through bid bond.
  - Suppliers and subcontractors are protected against non-payment by a contractor with a labor & material payment bond.
  - The owner receives protection against default, breach of contract or nonperformance by the contractor through a performance bond.
Disadvantages of bonds

• Bonding requirements may restrict bidding.
• Owners may not be aware of the magnitude of the surety’s obligations or services.
• Owners with large construction budgets may not be able to pre-qualify contractors.
1) Bid Bonds:

- A surety issues a *bid bond* to guarantee the contractor will, within a specified period of time, enter into a contract at the price submitted in the bid.
- The price of bid bonds vary, but 10% of the bid amount is generally accepted.
- If the bidder has failed to execute a contract, and the owner has made a claim to recover the difference in the two low bids from the surety, the surety has to pay the guaranteed amount to the owner.
- Three possible defenses a surety can make:
  - The low bidder can prove they made a mistake in the preparation of their bid.
  - The owner delays too long in making a contract award.
  - The owner tries to change the terms and the conditions of the contracts between the award and execution dates.
2) Performance Bonds:

Performance Bonds provide the most important protection for the owner. They guarantee the work will be completed in accordance with the contract document.

In case of a breach or default by the contractor, the surety has several options:

- The surety can finance the project by providing funds to the defaulting contractor to complete the work.
- The surety can pay the face amount of the bond to the owner.
- The surety can wait for termination of the contract with the original contractor, then complete the work with another contractor of their choice.

The surety does have some possible defenses against the claims made by the owner, such as the following:

- Breach of Contract – If the owner has breached the contract through wrongful delays, nonpayment of invoices and change orders.
- Overpayment – If the owner overpaid the contractor for the completed work at the time of the default.
- Material Alternation – In case of significant alternation without written notice to the surety.
3) Labor & Material Payment Bonds:

- They guarantee the project’s suppliers, subcontractors, and other providers of labor, materials, goods, and services will be paid.
- This bond is also beneficial to the owner. It provides protection from unpaid parties filing mechanics liens against the project property.
- A payment bond might generally cover:
  - Equipment rental
  - Freight and transportation fees
  - Repair charges for tools and equipment
  - Temporary structures, fuels, and union benefits.
- Items not generally covered under a payment bond include:
  - Insurance premiums
  - Workers compensation
  - Financial loans and taxes.
- Most payment bonds carry certain limitations to claims, which may vary from one jurisdiction to another.
Construction Insurance

- Construction Insurance provides protection for the proposed project and its participants (the owner, contractor and the architect/engineer) from physical damage and liabilities due to project losses.
- Each participant must carry adequate insurance coverage to protect themselves.
- Insurance requirements:
  - Owners insurance requirements.
  - Contractors insurance requirements.
  - Design professional insurance requirements.
- More details about construction insurance are in the following references:
Owners insurance requirements

- **Property Insurance**: damage to one’s own property from diverse causes as fire and theft is commonly insured against.
  - AIA Document A201 (paragraph 11.3) describes the types of loss protection typically carried by an owner on a construction project.

- **Owners Liability Insurance**: the owner is responsible for obtaining and maintaining their own general liability policies that apply to their normal operations and protect them against negligent acts by their employees or agents.
  - Liabilities are an obligation imposed by the law through either litigation or arbitration.
  - Liability insurance protects the owner in disputes over claims of wrong doing or acts of negligence.

- **Loss of Use Insurance**: owners may wish to consider securing protection of their premises in case they become unusable due to fire or other hazardous causes.
Contractors insurance requirements

- Property Insurance. Contractual requirements do not usually address the contractor’s obligation to carry adequate property insurance (for their personal properties), but it is a good business practice.

- Contractor’s Liability Insurance: A contractor may incur liability for damages in different situations, such as:
  - Liability to injured employees
  - Direct responsibility for injury or damage to the person (not employee) or property of third parties, caused by acts or omissions of the contractor
  - Liability that may involve the contractor as a result of the operation of their motor vehicles.
  - Contingent liability: involves the direct liability of the contractor for acts of parties for whom they are responsible, such as suppliers and subcontractors
Design professional insurance requirements

- Professional Liability Insurance: often overlooked by an owner is the need for adequate insurance coverage by the design professional.
  - The engineering function carries major liability if done incorrectly and should, therefore, be required to carry and maintain professional liability insurance.

- There are two types of this kind of insurance:
  - “claims made”: covers the engineer only for claims made, while the policy is in effect. (common)
  - “occurrence”: covers the engineer when acts occurs, while the policy is in effect. (unavailable)
General Insurance Topics

- Insurance Certificates.

- Owner-Controlled Insurance Program:
  - These types of programs are often referred to as “wrap-up” insurance coverage.
  - The owner provides all of the insurance for the project except design professional and contractor professional liability insurance.

- Construction Insurance Checklist:
  - Project Property Insurance.
  - Property Insurance on Contractors Own Property
  - Liability Insurance
  - Employee Insurance
  - Automobile Insurance
  - Business, Accident and Life Insurance
Construction Safety

- Construction is a hazardous business.
- Due to its inherent dangers, construction safety has always been a dominant concern of all parties associated with the industry.
- Legislation enacted in 1970 as the Occupational Safety and Health Act (OSHA) addresses safety requirements in all businesses.
- In the 1980s, the government started to fine the owners (not only the contractors) found violating any of the provisions of the law.
- Safety has now moved from the arena of good business practices into the criminal courts.
Safety programs on construction projects should be part of the overall risk management procedures of the owner and the contractor.

Reduction in construction accidents has several good benefits associated with it:
- It is humanitarian to be concerned about safety.
- It makes good business sense to reduce costs and losses due to accidents.
- It makes for good public relations.

Safety can be defined as an attitude.

Management has the responsibility to establish an environment in which unsafe work practices are not tolerated.
The importance of construction safety

- The construction industry employs about 5% of the total labor force.
- It has accounted for about 11% of the occupational injuries and 20% of the fatalities resulting from on-the-job accidents.
- At an annual cost estimated at about $10 Billion.
- When an injury results from an accident, not only the workers suffers physical damage or disability, but their families are directly affected as well.
- The owner and/or the contractor do have social responsibilities to the injured workers and their families and to the general public to operate a safe workplace.
- Management is only now becoming fully aware of the total cost of accidents on construction sites.
Safety Programs

- Owners and contractors alike need to plan and manage carefully a safety program established for a construction project to reduce the probability of accidents.
- The primary obstacle to safety program implementation in construction has traditionally been upper management’s lack of support.
- A safety program can begin with the identification of problems encountered on other similar projects or through experiences of the workers.
- An effective safety program can prevent accidents and increase worker productivity.
- Not only does a safe workplace lend itself to a productive atmosphere, but it also proclaims management’s commitment to the welfare of its employees and suppliers.