Second Edition

Understanding and Negotiating Construction Contracts

A Contractor's and Subcontractor's Guide to Protecting Company Assets

Kit Werremeyer

RSMeans

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This book is printed on acid-free paper.

Library of Congress Cataloging-in-Publication Data Applied for
Paperback ISBN: 9781394150205 [LCCN 2023011467]

Cover Design: Wiley
Cover Images: Courtesy of Geometrica, Inc;
joffi/Pixabay, Personal Photo By Kit Werremeyer

Set in 12/15pt Warnock pro by Straive, Pondicherry, India

Dedicated to all those contractors and subcontractors who are interested in learning how to negotiate more favorable commercial terms and conditions in their construction contracts and thereby better protect the hard-earned assets of their companies.

Contents

Acknowledgments

I am grateful to the following people who, by sharing their long-term experience in working with construction contracts, added significantly to this book.

John T. (J.T.) Wodarski and Joseph J. Newman Jr., each of whom has over 30 years of valuable experience in negotiating commercial terms and conditions of engineering and construction contracts, provided many suggestions for improvements in how the issues were covered in this book. Neither of these two friends (and tough negotiators) hesitated to challenge me to clarify or expand on some of the contracting and negotiating guidance I drafted. The results were significant improvements to the content of the book.

Robert W. Wolfe Esq. has negotiated and reviewed many large and small domestic and international engineering and construction contracts from a legal standpoint for more than 25 years. He kept me straight on the many legal fine points associated with the riskiest commercial terms and conditions found in contracts. He is the most practical and effective lawyer I have ever had the opportunity to deal with in the engineering and construction business.

Bruce Wilkinson Esq. has been working with a wide variety of contracts for over 35 years. He provided many insightful and useful comments and suggestions on construction contract commercial terms and conditions.

Gwen A. Schroder and Ed Jacobs shared their extensive knowledge of the insurance industry to help guide me through the technical issues associated with insurance for construction projects.

And my wife, Marilyn, a former teacher, reviewed every word in the book at least twice and made every effort to ensure my spelling and grammar were generally correct. While she did an excellent job, she told me she never again wants to read anything about indemnities. Amen.

About the Author

Kit Werremeyer is the owner and president of Southernstar Consultants LLC, of Valrico, Florida, a company that provides training in the understanding and negotiating of construction contracts. The company also offers a broad range of other professional services to United States and international engineering and construction companies.

Mr. Werremeyer's experience includes more than 30 years of sales, contracting, claims settlement, dispute resolution, and EPC project development, including work for a broad range of major U.S. and international companies, such as Bechtel; Kellogg, Brown & Root (KBR); Fluor; J.A. Jones; Black & Veatch; DuPont; Shell Oil; Caltex; Exxon/Mobil; BP/Amoco/ARCO; Air Products and Chemicals; Koch Industries; Florida Power and Light; Chiyoda Corporation (Japan); Japan Gasoline Corp.; Mitsui (Japan); Mitsubishi Heavy Industries (Japan); Petronas (Malaysia); Thai Oil Company; Pertamina (Indonesia); SINOPEC (Peoples Republic of China); Voest-Alpine (Austria); Daelim (Korea); and Hyundai (Korea).

Among prior positions, Mr. Werremeyer served as vice president and area director of sales and marketing in Asia for Chicago Bridge & Iron Company, an international engineering and construction company. This position included responsibility for contracting and the general management of area subsidiaries.

He is a graduate of the University of Illinois at Urbana-Champaign, Illinois, with a master's degree in mechanical engineering.

Preface

In 1977, I entered a year-long sales training course presented by my company, Chicago Bridge & Iron Company (CBI), an international engineering, procurement, and construction contractor founded in 1889. CBI believed that all of its salespeople must have a strong foundation in understanding, evaluating, and negotiating the commercial terms and conditions typically found in engineering and construction contracts. Specifically, the course was to prepare its future salespeople to provide clients with "one-stop shopping." This meant being able to work out all the technical and constructability details of the contract with the client, and then negotiating appropriate commercial terms and conditions without necessarily having to go back to CBI's legal department for advice.

This extra capability—evaluating and negotiating commercial terms and conditions for construction contracts—was designed to give us a clear edge over our competitors. We could work closely with the client on all aspects of the project—both technical and commercial—and then close the deal commercially without ever leaving his side or making an outside telephone call.

The sales training program included a lot of classroom time on such seemingly routine contractual considerations as terms of payment, scope of work, schedule, claims and disputes, termination and suspension, and warranties.

It also introduced us neophyte contractors to such new and mysterious contractual terms as indemnity, additional insured status, force majeure, advance waivers of rights, specialty insurance

coverage, and assurances of performance. The instructors told us horror stories about the financial consequences that arose out of accepting a client's risky commercial terms and conditions for engineering and construction contracts.

This training course set the path of my career as, for the next 25 years, I worked in several different sales offices located on the East Coast and the Midwest of the U.S. and for 13 of those 25 years, in Southeast Asia. I participated in and/or managed the negotiations of the commercial terms and conditions for hundreds of engineering and construction contracts ranging in value from small $50,000 repair projects, to major engineering, procurement, and construction (EPC) projects worth over $100 million. Clients ranged from small owners to major international oil, gas, chemical, and petrochemical clients, and major domestic and international EPC contractors from the U.S., Europe, and Asia.

There were a huge variety and complexity of commercial terms and conditions in all these contracts over those 25 years. Every owner or EPC contractor had their own favorite idea of what constituted acceptable commercial terms and conditions. Negotiating acceptable terms and conditions for CBI projects was always a challenge; nothing ever was the same. On a few occasions, the client's commercial terms and conditions were so one-sided and unacceptable, and the client was so reluctant to change them, that the only thing left to do was close the file and walk out the door. It was time to let some other poor contractor suffer with those lousy commercial terms and associated risks.

When I retired in 2001 after 32 years with CBI to form my own company, I looked back at all the diverse practical negotiating experience I had with engineering and construction contracts in the U.S. and internationally and felt it was important to write a practical, user-friendly, and non-legalistic book about this subject. It is my hope that my own experience will help contractors, regardless of the size or sophistication of their companies, to negotiate better and less risky commercial terms and conditions for construction contracts—and thereby better protect their assets.

I hope that contractors can learn something from this book and use it as a practical desk reference. If by reading this book, they learn nothing more than to be able to better identify, understand, and evaluate risky commercial terms and conditions, and then negotiate or otherwise seek help to resolve them, I have succeeded.

Disclaimer

During the course of writing this book, I was reminded on several occasions by my good friends and excellent reviewers that I needed to include a written disclaimer regarding the reader's use of the contracting and negotiating guidance provided—as it is impossible to anticipate all the circumstances that may arise in a construction contract. I have tried my best to provide what, in my experience and opinion, is practical information gained from my over 30 years in the engineering and construction business. My hope is that this book will help contractors and subcontractors understand, evaluate, and favorably negotiate construction and construction-related contracts and thereby help protect their assets.

I do not provide any express or implied warranty on the use of any of the information contained in this book as it may be applied to understanding, evaluating, and negotiating construction contracts. Readers should consult, as needed, with professionals on their particular contracts and circumstances.

– Kit Werremeyer

Introduction

There is no price for bad terms.
~ Construction contractor from Toledo, Ohio

The Goals of This Book

This book was written with three important goals in mind:

1. Assisting contractors in improving their abilities to identify, understand, and evaluate certain high-risk commercial terms and conditions typically found in all construction contracts.
2. Providing contractors with negotiating suggestions on how to lower or eliminate the risk associated with commercial terms and conditions.
3. Providing straightforward information in as uncomplicated and non-legalistic a manner as possible.

The book will help contractors in their effort to negotiate favorable commercial terms and conditions for their construction contracts. By doing so, this will help lower their commercial risk; assist in improving their terms of payment; and reduce their exposure to claims, disputes, and unnecessary or inappropriate risk transfer and its associated potential financial liability.

What Are the Benefits of This Book?

Contractors must be able to identify, understand, and evaluate all the commercial risks that are accepted by agreeing to an owner's proposed contract. They must then be able to effectively minimize and manage those commercial risks—mitigating or eliminating them through negotiations—and thereby lessen their exposure to any potential financial liabilities. This will ultimately *protect the assets of their companies*. This is the primary benefit of this book.

Contractor & Owner Conventions

This book refers to contractors and owners—both in the general sense, and capitalized in actual sample contract clauses. "The contractor" refers to you, the reader of this book—whether general contractor or subcontractor—working hard in the construction business trying to make a living. "The owner" refers to the company that the contractor is providing construction work for, and with whom he will sign a construction contract. **(Note that throughout this book, the masculine singular "he" is used, for simplicity only, and to avoid the more cumbersome "he/she"/"his/her" construction.)**

Also for simplicity, the book refers to the construction contract between the owner and contractor. Often, however, the contractor will have a contract with another construction company who works for the owner, perhaps in the role of the owner's project manager, or the owner's main contractor. In this case, the contractor would typically be considered a subcontractor, and his construction contract would likely be called a subcontract with the owner's project manager or main contractor. It doesn't matter whether the contract is made directly with the owner, or whether it's a subcontract with the owner's PM or main contractor—the information contained in this book about understanding and negotiating construction contracts applies equally to all of these contracting relationships.

Private Contracts or Government Contracts?

The contracting concepts presented in this book apply to contractors working with private U.S. owners, and not federal or state government owners. Construction contracts with U.S. federal, state, and local governments may have different commercial contracting challenges. Sometimes, for instance, government contracts are, by law, nonnegotiable with respect to the types of commercial terms and conditions a contractor must accept. However, the concepts and suggestions in this book can be used to help better understand and manage similar commercial issues in government construction contracts, and can assist the contractor, particularly in those situations where negotiation is an acceptable part of the government's contracting process. In Chapter 16, "International Contracting," the additional concepts presented also apply to contracts between a private contractor and a private owner. Contracting with foreign governments and their various departments often presents exceptional contracting challenges that are beyond the scope of this book.

Key Contracting Concepts

Throughout this book, two key contracting issues with construction contracts are discussed:

- **Commercial Risk:** The risk associated with the potential for the contractor to be harmed in some way by accepting the wording

in an owner's construction contract's commercial terms and conditions.

- **Potential Financial Liability:** The possibility of having to pay money, which would arise from the obligations that a contractor agrees to accept in the owner's construction contract's commercial terms and conditions, and that might arise also from the contractor's common law obligations. Common law is the body of law that develops out of decisions made by courts—called precedence—rather than law that is created by statute.

Examples of Commercial Risk

Commercial risk creates an exposure to the potential for financial liability and flows directly from the commercial terms and conditions contained in the owner's construction contract. Commercial risk is probably the risk a contractor finds most difficult to understand and manage. Some typical examples of a contractor's exposure to commercial risk found in a construction contract's commercial terms and conditions are:

- Exposure to the financial liability to pay liquidated damages or other consequences of contractor's late performance.
- Exposure to the financial liability to pay for damages that are caused by the owner's negligence.
- Not being paid for legitimate changes for additional work.
- Not being able to settle legitimate disputes in favor of the contractor.
- Exposure to an owner cashing in a contractor's performance or payment bond without legitimate reasons.
- Exposure to the financial consequences—not enough cash to pay bills—of not being paid by the owner on time for progress payments.
- Exposure to the financial liability that may arise out of lengthy warranty periods or requests by an owner to perform warranty work that is really not warranty work.
- Exposure to the financial liability that may arise out of other risks encountered on a construction project, such as differing site conditions and force majeure.

Two Types of Commercial Terms & Conditions

The commercial terms and conditions typically found in a construction contract can be split generally into two categories:

- Administrative terms
- Financial liability terms

Administrative terms are those commercial terms and conditions that have a low probability of creating a significant financial liability for the contractor. Financial liability terms have a high probability of doing so. The focus of this book is to improve the contractor's ability to understand and evaluate these financial liability terms and conditions and learn ways to lower or eliminate the commercial risk associated with them through effective negotiations.

A typical construction contract can be divided between administrative and financial liability terms as shown in Figure 1.

This book will discuss only those commercial terms and conditions that tend to create a high probability of financial liability for the contractor. This doesn't mean, however, that other terms and conditions should be ignored or taken lightly. It just means that if the contractor has to focus his effort primarily on one of these sets of commercial terms, it should be on the commercial terms that have the greatest potential for harm.

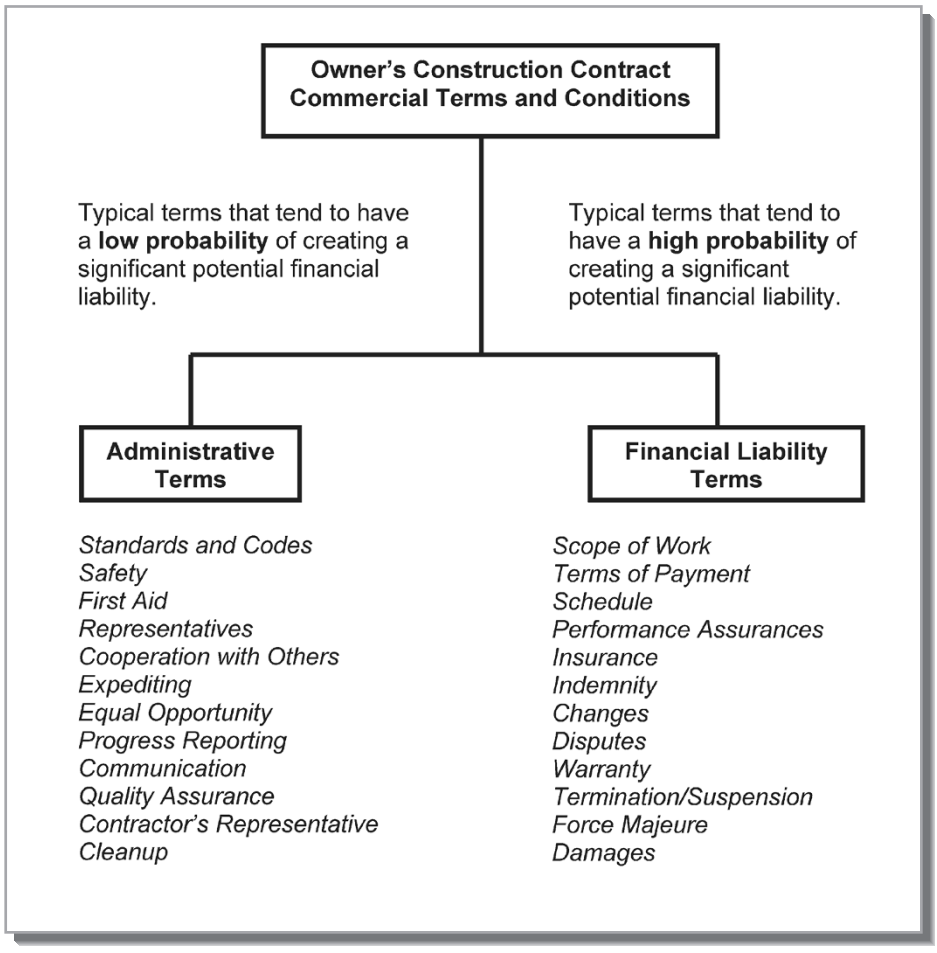

Figure 1: Types of Contract Terms

The Most Important Commercial Terms & Conditions

The three most important commercial terms and conditions contained in all construction contracts are:

1. Scope of work
2. Pricing and terms of payment
3. Schedule

These commercial terms are the *three foundation stones* of all contracts, as shown in Figure 2.

The Contracting Process

Here's a bold statement: *There is no difference between a construction contract for a new one-story office building worth $500,000 and a new grassroots oil refinery worth $1 billion.* Think about this for moment. The contractor for each project must have a written construction contract to perform the work described. Each contract will have a scope of work section, terms of payment, and a schedule. Further, each contract will likely have contractual obligations for insurance, warranty, changes, dispute resolution, termination and suspension, damages, indemnity, and assurances of performance.

Certainly, the complexities of the two projects are significantly different, but the contracting process of understanding and negotiating commercial risk issues and potential financial liability issues are the same, and must be properly dealt with by each contractor in order to protect the assets of their companies.

Excuses for Not Negotiating Better Commercial Terms & Conditions

What are the typical excuses given by contractors when faced with the prospect of having to try to negotiate better commercial terms and conditions in the owner's construction contract? Some of the most common:

- "It's too hard to deal with the owner and his lawyers."
- "The owner will disqualify me if I take exception to his terms and conditions."

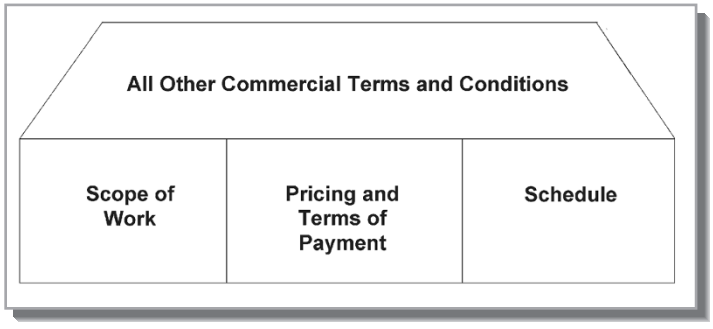

Figure 2: Three Foundation Stones of a Contract

- "I don't understand the terms and conditions well enough to negotiate better ones, and I don't want to hire a contracts expert or a lawyer."
- "The competition accepts the owner's terms and conditions all the time, so I don't have much of a chance."
- "I don't like to negotiate. Maybe the best thing to do is just sign the contract, put it in the bottom drawer of the desk, and hope nothing happens."

The last excuse basically says this: "sign, do nothing, and pray for the best." This strategy works fine as long as nothing goes wrong during the execution of the contract. However, things often do go wrong during the course of executing construction contracts!

Let's say the owner creates lengthy delays to the construction schedule, refuses to acknowledge his fault, then penalizes the contractor by imposing liquidated damages for late performance. Once something like this happens to a contractor just once in his lifetime, he will wish he had made the effort to negotiate more favorable commercial terms and conditions prior to signing the contract.

One good reason to negotiate changes to the owner's commercial terms and conditions is simply to improve the contract for the benefit of the contractor, and to lower the contractor's exposure to potential financial liability at the same time.

For example, creating a detailed scope of work document that carefully outlines what the contractor, owner, and all other parties involved in the contract are obligated to do will *always* serve to minimize misunderstandings and disputes over the scope of work. Often the contractor has the best experience and background to assist the owner with developing a detailed and comprehensive scope of work document.

The Concept of Risk Transfer

Another contracting concept that will be discussed throughout the book is the concept of risk transfer. Commercial terms and conditions, such as those associated with insurance and indemnity clauses, transfer the risk of potential financial liability for certain events from one organization to another. Insurance transfers the risk of certain potential financial liabilities from the contractor—the named insured—to the insurance company in return for the payment of a premium. An indemnity clause in a construction contract can transfer to the contractor the risk of certain potential financial liabilities that may arise due to the negligence of the owner—in return for nothing!

Contractors must understand the consequences of accepting risk transfer clauses in a construction contract. Negotiating changes to risk transfer clauses can significantly lower exposure to the possibility of unnecessary or unwarranted financial loss.

This Is a Book Developed Just for Contractors

Every attempt has been made to write this book in as non-legalistic a manner as possible. It was written for those contractors who have no legal training in contract law and are simply in business to engineer, procure, and safely build construction projects.

Anyone who is willing to take the time to understand the basic concepts of construction contracting can become effective in understanding, evaluating, and managing commercial risk and negotiating more favorable commercial terms and conditions. Can a lawyer who specializes in construction contracting help a contractor understand and negotiate a construction contract? Certainly he can, but that assistance, and cost, is not always necessary.

Before the contractor signs the contract, he needs to understand the commercial risks and their possible financial consequences. The contractor's assets are at stake.

The book features samples of actual contract language—both the good and the bad, the fair and the unfair. Each chapter contains these easy-to-understand clauses, in boxes for quick reference, which show contractors the kind of language that should be used, as well as jargon and unreasonable terms that should be avoided. Having a good working knowledge of the major commercial issues involved in construction contracting will help a contractor understand what he is getting into, the risks he is taking, and the risks he doesn't want to take.

This book is not designed to be anti-lawyer or anti-owner. It is designed to be pro-contractor.

Is the contractor agreeing to a fair contract, or taking on a lot of unnecessary responsibilities and commercial risks? Will he get paid on time? These are the types of questions a contractor will be able to answer and resolve after reading this book—before signing a construction contract.

It may appear when reading through this book that owners are cast in a bad light, and that all too often they demand unacceptable commercial terms and conditions. This is not true. Some progressive owners have, or will negotiate, commercial terms and conditions that are fair and balanced for both parties—the owner and the contractor. The contractual issues covered in this book are meant to raise the awareness of contractors to worst-case situations that can arise from accepting certain commercial terms and conditions in a construction contract—and how to edit and reword unfair clauses.

Three Final Suggestions

Finally, contractors should remember these three important things:

1. Read and understand everything in the construction contract.
2. Negotiate better commercial terms and conditions with the goal of reducing commercial risk and the associated exposure to potential financial liability.
3. Get all agreements in writing from an authorized representative of the owner!

Chapter 1 Contracts: Basic Training

What Is a Contract?

This isn't a trick question, and it doesn't have a complicated answer. For the purposes of this book, the following definition will be used:

A **contract** is a written agreement that clearly defines the responsibilities and obligations of each included party, is legally enforceable, and is dated and signed by an authorized representative of each party.

A contract may also be called an agreement. The term contract will be used throughout the book.

The Steps to a Contract

1. Receive an inquiry or request for proposal (RFP) from the owner.
2. Prepare a proposal for the work and submit it to the owner.
3. Negotiate all the details of the contract with the owner.
4. Sign the contract.

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It doesn't appear to be too complicated, does it? However, there are hundreds of issues—small and large—to consider and things to do during the process of responding to an owner's RFP. The contractor must:

- Review and analyze all the written bid documents, including any attached plans, drawings, and specifications.
- Resolve questions about the scope of work.
- Visit the site.
- Assess the physical and commercial risks.
- Select subcontractors and suppliers.
- Prepare an estimate and proposal.
- Review and comment on the commercial terms and conditions.
- Sort out insurance details.
- Negotiate improvements to the contract.

This chapter covers the basic concepts of contracting and explains some of the terminology contractors most often encounter.

Coming to the Party?

So who is a party to a contract? In almost all construction contracts, there will be at least two parties. One is the contractor (who is going to build something), and the other is the owner (who has a need for what is being built). If the owner hires a project manager to manage all the contractors on the project, then the owner's project manager would also be considered a party to the contract.

All persons or organizations that have not signed the contract are called third parties.

Some typical third parties a contractor might see at or near the project job site are:

1. The owner of the commercial property and buildings adjacent to the project site.
2. An OHSA safety inspector making a visit to the job site.
3. Another contractor, his subcontractors, and their personnel who are also working for the owner on the project site.
4. Subcontractors working for the contractor who are not signatory to the contract with the owner.
5. Local private homeowners or small business owners and tenants adjacent to the site.
6. Environmental protection groups.
7. The general public, who may wander onto the job site.

The Risk Associated with Third Parties

What's all the fuss over this business of third parties? The actions of these people or organizations can create serious commercial risks and potential financial liability for both the contractor and owner. Contractors must manage a multitude of job site safety issues in order to avoid employees' injuries.

Damage to a third party's adjacent property or injury to a third-party individual, such as a member of the general public, exposes both the owner and the contractor to lawsuits, legitimate or otherwise, that could financially ruin either or both of them.

Much of the concept of **commercial risk transfer** involves transferring risk from the owner to the contractor. Risk includes potential financial liability associated with damage to property belonging to third parties and injury to or death of third-party individuals, regardless of any contributing fault or negligence of the owner. This transfer of risk is accomplished mainly by the use of indemnity and additional insured clauses. (These topics are covered in detail in Chapters 7 and 8 of this book.) So although the contract is between the contractor and the owner, the contractor has to recognize that individuals or organizations not associated directly with the contract—third parties—may have an impact on the contract risk.

The Starting Point

The starting point for a construction contract is when an individual or company decides to construct a new facility to meet its needs.

An Example

Wilson Properties conducts a search of local building contractors and finds several that are qualified, including National Construction Company.

Wilson Properties prepares a written inquiry, or as it is commonly called, a ***Request for Proposal*** *(RFP), and sends it out to several contractors for competitive bids. The RFP would typically include:*

- *A description of the scope of work*
- *Some idea of a schedule*
- *The plans and specifications prepared by a design team and approved by the building department*
- *Applicable codes and standards*
- *Commercial terms and conditions the owner expects the contractor to accept*

The RFP might also require the contractor to indicate in writing whether he will provide a proposal for the work by the time specified in the inquiry, or whether he will decline to bid.

"Here's My Proposal"

The written proposal, such as prepared by National Construction Company, to perform the work is called an **offer** and is the first half of the contracting concept of **offer and acceptance**. The offer will include the contractor's price and schedule to perform the work and may contain responses to information requested by the owner's inquiry. It may also address specific work scope and commercial clarifications, as well as any other concerns of the contractor.

An Example

National Construction Company may propose a different completion schedule than required by Wilson Properties' RFP documents, technical substitutions, or other cost- or time-saving alternatives. National Construction Company may also propose changes to the commercial terms and conditions that were included in the Wilson Properties' RFP documents.

"And I accept, but…"

Wilson Properties receives the proposal (offer) to perform the work from National Construction Company, reviews it for general compliance with the RFP, and decides that it is a good offer and that they would like to award the project to National Construction Company.

However, Wilson Properties has some issues with the schedule, the price, and the clarifications to the commercial terms and conditions proposed by National Construction Company. Wilson Properties has National Construction Company come to their office to negotiate and tells them, "We would like to accept your offer, but…" The two companies then proceed to negotiate a mutually agreed-on schedule, price, and set of commercial terms and conditions.

The acceptance of the offer in this instance is actually a process. Wilson Properties and National Construction Company negotiate back and forth until they reach a mutually-agreeable deal. The final offer is defined through the negotiations, and both parties say, "Okay, we agree. We have a deal." This back and forth negotiation is the contract negotiation process.

All of the negotiated changes to Wilson Properties' original RFP are documented in writing. The best way to do this is to make the appropriate changes in the body of the signed contract. An alternate way is to document all the changes in a separate letter signed by

Offer and acceptance is the technical term used to test whether a contract has been arrived at or not. A more workable and practical definition of the offer and acceptance process is successful contract negotiations.

both parties noting that the changes agreed on supersede and take precedence over the contract and any similar or conflicting provisions.

Wilson Properties then advises National Construction Company in writing that they have been awarded the project, referencing the original RFP and the letter documenting all the negotiated changes to the RFP.

This written notification by Wilson Properties signifies their acceptance of National Construction Company's offer, as was revised and agreed on through the two companies' negotiations.

These are the first two key steps taken in the process of arriving at a contract: offer and acceptance.

"Consideration," or Something of Value

Each party to the contract must receive something of value in order for the contract to be legally enforceable. In the previous example, the contract calls for Wilson Properties to receive a new office building that will be built in accordance with the RFP—and the changes to the RFP mutually agreed to in writing by both parties. The finished building that Wilson Properties will receive is referred to as **something of value.**

National Construction Company receives the agreed-on contract price to construct the building for Wilson Properties. The money—contract price—that National Construction Company receives is also considered something of value. Both parties to the contract receive something of value, also known as **consideration**.

The "Happy Test"

Both parties must mutually and freely agree to all the conditions spelled out in the contract. In order for the contract to be legally enforceable, neither party can use coercion to get the other party to sign. A contract cannot obligate one party or the other to do something illegal. An illegal obligation would cause the contract to be unenforceable.

For example, if one party to a contract brings in a group of armed thugs and says to the other party, "sign, or else," then that clearly is coercion, and the resulting contract would not be legally enforceable. This is an extreme example, but it makes the point.

If the written conditions in the contract require one of the parties to have the responsibility of periodically bribing the local customs official (an illegal act) in order to have him under-apply import duties, then the contract would not be enforceable. There can be nothing in a contract that requires one party or the other to do something illegal. The best advice is: when in doubt, don't agree to do it.

"Can That Person Sign This Contract?"

There are two issues here: the first one involves the competency of the person signing the contract, and the second one involves whether that person has the authority to sign. Both parties signing the contract must be competent. If the person signing the contract is under the influence of drugs or alcohol, or has a serious mental incapacity, then that person probably does not have the competency to sign the contract. The contract would likely be legally unenforceable. A more common concern is whether the person signing the contract for one of the parties has the authority to do so.

An Example

A young employee of the owner who has just graduated from college is getting ready to sign a high-value EPC contract on behalf of the owner for a major expansion to a complex petrochemical plant. The contractor for the expansion questions the young person's authority to sign the contract. The contractor is accustomed to having much more senior representatives of the owner sign contracts for such major projects.

A contract may be unenforceable if it is signed by someone who does not have the proper authority to commit the party he represents to the requirements in the contract.

In a situation like this, the contractor might request that the proposed signer of the contract produce a power of attorney document from the company president, or some other senior officer, granting specific authority to sign the contract. This is a simple solution to resolving the issue of proper authority.

It's not too unusual for the owner's RFP to require the contractor to have an officer of the company sign the contract. If someone other than an officer of the contractor's company plans to sign the contract, then he must present to the owner an appropriate power of attorney document giving the signer the authority to sign contracts and commit the resources of the contractor.

Call in the Enforcer to Close the Breach!

What does the term **legally enforceable** mean? A legally enforceable contract exists when:

1. A written contract has been negotiated (offered and accepted), without any coercion, between the owner and the contractor.
2. There is nothing illegal contained in the contract.
3. The contract has been signed by representatives of the owner and the contractor. The contractor and owner (or representatives) have the authority to commit the resources of their companies.

If a contract is legally enforceable, the owner can, if necessary, sue the contractor in court to make him live up to his agreed-on obligations as defined by the contract. Likewise, the contractor can, if necessary, sue the owner in court to make him live up to his agreed-on obligations. The court can act as an enforcer of contract obligations.

Into the Breach!

If the owner or the contractor does not abide by his respective obligations as contained in the contract, then he may be determined to be in **breach of contract**. This just means that someone who is party to the contract is not living up to what he has contractually agreed to do. Breach of contract is also commonly called **failure to perform**. It's mentioned here only because the issue rears its head all the time. How many times have contractors heard it said that, if you don't do this or that, you are in breach of the contract?

There is no reason to get excited; the term is overused to exert leverage on the contractor and is subject to far too many personal interpretations.

An Example

> *If an owner agrees in the contract to pay the contractor's payment invoices 30 days from the date of each invoice, and does not pay until the 32nd day, then the owner technically has committed a breach of contract. The owner may have a variety of reasons—legitimate or otherwise—why he didn't pay the contractor on time as required by the contract, but he is still technically in breach of contract. Unfortunately, the contractor would have to go to court to have it determined that the owner was actually in breach of contract. It's always better to find a way to resolve the issue with the owner to get him to live up to the terms of payment he agreed to accept.*

The court acts as an enforcer in breach of contract disputes by compelling the party who has failed to perform to live up to his contractual obligations, or else pay monetary damages to the other party.

Sometimes a contractor will hear the owner use the term **material breach of contract**. Like many things in a contract, this term is open to much interpretation. In general, a material breach of contract is a failure to perform a contractual obligation, and the failure is extremely serious and damaging to one or both parties.

In the previous example, the owner paid the contractor on the 32nd day and so was two days late. That probably would not stand up to the test or interpretation of what constitutes a material breach of contract. However, if the owner paid the contractor 60 days late and did not have a legitimate reason for the delay, it would certainly have a much better chance of being deemed so.

A Contract Example

The following is an example of a simple "supply and install" construction contract that illustrates contracting basics.

An Example

National Construction Company responds to Wilson Properties' RFP for a new office building, negotiates the details (offer and acceptance), and enters into a construction contract, agreeing to supply and construct the office building (something of value for Wilson Properties) in accordance with the drawings and specifications contained in the RFP.

National Construction Company also agrees to perform the work within a fixed time period and for a certain fixed price (something of value for National Construction Company). National Construction Company is to receive a downpayment from Wilson Properties prior to starting the work, and will receive the balance upon satisfactorily completing the building.

No coercion was used by either party regarding the terms of the contract, and the contract does not include any illegal requirements. The contract document is signed by Wilson Properties' President and by National Construction Company's Project Manager (competent parties with authority).

In written form, the contract would look something like this:

Article 1 – Scope of Work and Price

National Construction Company agrees to supply and build a one-story office building on a site provided by Wilson Properties strictly in accordance with the attached Plans and Specifications for a fixed, lump-sum price of $250,000.

Article 2 – Schedule

National Construction Company agrees to complete the one-story office building within one year from the date of this Contract.

Article 3 – Terms of Payment

Wilson Properties agrees to pay National Construction Company $50,000 as downpayment immediately upon the signing of this Contract, and the balance of $200,000 immediately upon the completion of the one-story office building.

Dated: January 1, 2007

Signed:

Wilson Properties	National Construction Company
_____	_____
President	Project Manager

This is an example of a legally enforceable construction contract in its simplest form. But that's all that's actually required. It includes all the basics:

1. National Construction Company made an offer.
2. Wilson Properties accepted the offer.
3. National Construction Company provides something of value: the one-story office building.
4. Wilson Properties also provides something of value: the payment of $250,000.
5. The contract document is signed by a representative of each company who is competent, and who also has the authority to commit the resources of the company.
6. No coercion was used and no illegal activities are required.

This sample contract is extremely simple, but it would be perfectly legal and enforceable. However, almost all construction contracts will very likely be a lot more complex and will have numerous additional clauses to cover a variety of commercial terms and conditions, such as insurance, indemnity, performance and payment bonds, changes, dispute resolution, safety requirements, and schedule and progress reporting requirements.

This example could have been expanded to include an additional clause requiring National Construction Company to provide Workers' Compensation insurance and other types and amounts of insurance, which would read as follows:

Article 4 – Insurance

National Construction Company will provide statutory Workers' Compensation insurance in accordance with state laws, Comprehensive General Liability insurance in the amount of $1,000,000, and Automobile insurance in the amount of $300,000.

These insurance requirements are typical. Most states require contractors to participate in a Workers' Compensation insurance program, and owners typically require contractors to also provide General Liability and automobile insurance at a minimum.

All the clauses in a construction contract are collectively called the **commercial terms and conditions**. Commercial terms and conditions define all the responsibilities and obligations of each party to the construction contract.