

Construction Contracting Primer

Panel Discussion

Comments by Jim Schenck, Conner Gwyn Schenck PLLC:

Limitations and constraints on what you can do when problems arise: termination risks, inadequate contract provisions, and dealing with sureties.

DESIGN PROFESSIONALS:

Although rare, sometimes owners must decide whether circumstances justify removal of an architect or engineer from a project. Before deciding to remove a design professional, owners should consider the following possible adverse consequences, at least:

- Difficulty engaging a replacement design professional
 - Re-procurement of a new design professional could be subject to Article 3D of the General Statutes, resulting in project delays.

§ 143-64.31. Declaration of public policy (a) It is the public policy of this State and all public subdivisions and Local Governmental Units thereof, except in cases of special emergency involving the health and safety of the people or their property, to announce all requirements for architectural, engineering, surveying and construction management at risk services, to select firms qualified to provide such services on the basis of demonstrated competence and qualification for the type of professional services required without regard to fee other than unit price information at this stage, and thereafter to negotiate a contract for those services at a fair and reasonable fee with the best qualified firm. If a contract cannot be negotiated with the best qualified firm, negotiations with that firm shall be terminated and initiated with the next best qualified firm. Selection of a firm under this Article shall include the use of good faith efforts by the public entity to notify minority firms of the opportunity to submit qualifications for consideration by the public entity.

§ 143-64.32. Written exemption of particular contracts Units of local government ... may in writing exempt particular projects from the provisions of this Article in the case of: (a) Proposed projects where an estimated professional fee is in an amount less than thirty thousand dollars (\$30,000), or (b) Other particular projects exempted

in the sole discretion of the ... unit of local government, stating the reasons therefor and the circumstances attendant thereto.

- Convincing another design professional to assume responsibility

21 NCAC 02 .0206 REQUIREMENT FOR AND USE OF PROFESSIONAL SEAL

(a) as more fully set out in this rule, an architect must seal his/her work whether or not the work is for an exempt project as defined in North Carolina general statute 83A-13. An architect shall not sign nor seal drawings, specifications, reports or other professional work which were not prepared by the architect or under his/her responsible control.

(d) Responsible Control. No architect shall affix his/her seal and signature to contract documents developed by others not under his responsible control. Responsible control includes that amount of control over and detailed professional knowledge of the content of technical submissions during their preparation as is ordinarily exercised by an architect applying the required professional standard of care, including:

- Dissemination of programmatic requirements;
- Ongoing coordination and correlation of services with other aspects of the total design of the project;
- Verification with consultant that owner's requirements are being met;
- Authority over the services of those who assisted in the preparation of the documents;
- Assumption of responsibility for the services;
- Incorporation of services and technical submissions into design documents to be issued for permitting purposes; and
- Incorporation and integration of information from manufacturers, suppliers, installers, the architect's consultants, owners, contractors, or other sources the architect reasonably trusts that is incidental to and intended to be incorporated into the architect's technical submissions if the architect has coordinated and reviewed such information

21 NCAC 56 .0701 Rules Of Professional Conduct [Engineers and Land Surveyors]

(a) In order to safeguard the life, health, property and welfare of the public and to establish and maintain a high standard of integrity, skills, and practice in the professions of engineering and land surveying, the rules of professional conduct in this rule are adopted in accordance with G.S. 89C-20 and are binding upon every

person holding a certificate of licensure as a professional engineer or professional land surveyor (licensee), and on all business entities authorized to offer or perform engineering or land surveying services in this state. All persons licensed under the provisions of chapter 89C of the general statutes are charged with having knowledge of the board rules, including the rules of professional conduct, and are deemed to be familiar with their provisions and to understand them.

(c)(3) Shall not affix the signature or seal to any ... plan or document not prepared under the licensee's direct supervisory control. Direct supervisory control (responsible charge) requires a licensee or employee to carry out all client contacts, provide internal and external financial control, oversee employee training, and exercise control and supervision over all job requirements to include research, planning, design, field supervision and work product review. . . . The licensee may affix the seal and signature to drawings and documents depicting the work of two or more professionals provided it is designated by a note under the seal the specific subject matter for which each is responsible; and

(4) In circumstances where a licensee in responsible charge of the work is unavailable to complete the work,...a successor licensee may take responsible charge by performing and documenting all professional services to include developing a design file including work or design criteria, calculations, code research, and any necessary and appropriate changes to the work. The non-professional services, such as drafting, need not be redone by the successor licensee but must distinguish in a clean and obvious manner and accurately reflect the successor licensee's work. The burden is on the successor licensee to show such compliance. The successor licensee shall have control of and responsibility for the work product and the signed and sealed originals of all documents.

- Cost of replacing design professional
 - Given the complexities of engaging a replacement design professional, the owner should anticipate that the fee requested by the replacement design professional will exceed the balance of the unpaid fee under the contract with the original design professional. The owner should assume that the professional liability insurance carrier for the original design professional will contest coverage for the fee overrun under any applicable professional liability policy.
- Contractual Barriers to Termination of the Design Professional
 - Typical contract: **AIA-B141 (1997)**: § 1.3.2.2 Upon execution of this Agreement, the Architect grants to the Owner a nonexclusive license to reproduce the Architect's

Instruments of Service solely for purposes of constructing, using and maintaining the Project, provided that the Owner shall comply with all obligations, including prompt payment of all sums when due, under this Agreement. The Architect shall obtain similar nonexclusive licenses from the Architect's consultants consistent with this Agreement. Any termination of this Agreement prior to completion of the Project shall terminate this license. Upon such termination, the Owner shall refrain from making further reproductions of Instruments of Service and shall return to the Architect within seven days of termination all originals and reproductions in the Owner's possession or control. If and upon the date the Architect is adjudged in default of this Agreement, the foregoing license shall be deemed terminated and replaced by a second, nonexclusive license permitting the Owner to authorize other similarly credentialed design professionals to reproduce and, where permitted by law, to make changes, corrections or additions to the Instruments of Service solely for purposes of completing, using and maintaining the Project.

- **SCO OC-22 (2009): 10-3** - In event of termination, the Designer shall receive payment for services rendered prior to the receipt of written termination notice from the Owner. If termination results from abandonment or suspension of the project, then the Designer will receive termination expenses in the amount of five percent (5%) of the above due payment. If termination results from non-performance of work, then the Designer will not receive termination expenses. Any work done by the Designer prior to termination shall become the property of the Owner.
- Other Issues:
 - Discontinuity of professional responsibility
 - Loss of project records: As-built records; daily reports; photographs, meeting minutes, etc.
 - Contractor claims due to delays.

CONTRACTORS AND CONSTRUCTION MANAGERS:

The decision to terminate a general contract or CMAR contract is also fraught with adverse consequences. Unless a contractor abandons the project or is clearly unable to complete it, most owners eventually shy away from removing a prime contractor. There are ample reasons for their reluctance.

- Liability for wrongful termination: The prime contractor is likely to contend that the decision to terminate the contract was unjustified and constitutes a breach of contract by the

owner. If the contractor resorts to litigation and successfully argues that termination was wrongful, the contractor can collect damages for breach of its contract, basically its lost profit on the project. The owner could find itself paying both re-procurement costs and damages to the removed contractor.

- **Difficulty Procuring a Replacement Contractor.** There are actually two constraints here: public procurement rules and the role of the performance bond surety.
 - If the prime contractor is a hard-bid contractor, the owner must decide whether normal procurement rules apply to the re-procurement.

§ 143-129. Procedure for letting of public contracts-(e) Exceptions. - The requirements of this Article do not apply to:

 - (2) Cases of special emergency involving the health and safety of the people or their property.
 - (4) Construction or repair work undertaken during the progress of a construction or repair project initially begun pursuant to this section.
 - It is not clear that either of the foregoing exceptions would apply to procurement of a contractor that has been removed from a project.
 - If the prime contractor is a construction manager, procurement follows the same general rules as procurement of a design professional under Article 3D of Chapter 143.
 - Regardless of whether the contractor is a prime, hard bid contractor or a construction manager, the performance bond surety will have rights that the owner must either acknowledge and honor, or waive. Depending on the circumstances, the surety could:
 - Contend that termination was unjustified and that there is no obligation owed under the bond.
 - Acknowledge the default and tender the penal sum of the bond, or some lesser negotiated lump sum amount, to the owner for a release.
 - With a reservation of rights, step in and hire a replacement contractor to finish the work (depriving the owner of the right/privilege of retaining the replacement contractor).
 - With a reservation of rights, allow the owner to engage a replacement contractor, and fund the completion work if the remaining balance under the

construction contract is not sufficient to cover the cost of the replacement contractor.

- There is a very real chance that the original contractor will be tapped by the surety to finish the project, under surety supervision, if the contractor has the ability to perform.
- The surety will have an equitable lien on any unpaid contract funds under the original contract.
- Discontinuity of Subcontractors and Suppliers - the termination of a prime contract or CMAR contract can result in the cancelation of all of the related supply contracts and subcontracts. Loss of the original subcontractors and suppliers can exacerbate many problems, including the cost of re-procurement, and the other problems mentioned below:
- Discontinuity of Warranties – Many subcontractors will refuse to honor warranties if they are not allowed to complete their work. Many material suppliers will not honor warranties if there is a change in installer.
- Discontinuity of Insurance - if a loss is incurred after replacement contractors are brought onto a project, coverage disputes between the insurers for the original contractors and the replacement contractors are a serious risk.
- Loss of Records (As-built drawings; inspections; manuals; etc.) As is the case with the design professional, termination of a contractor or team of contractors can result in the loss of important project records.

Helpful Contract Clauses You Will Not find in all Standard Forms

- Ensure that all project participants provide the owner with copies of all critical project records during the course of the project, as they are created.
- Always shop for project-specific insurance coverage; it will not always be affordable, but if it is, project-specific insurance closes many insurance gaps.
- In the design professional contract, you should delete any language that prevents you from using the project drawings and specifications to complete the project if you remove the design professional.
- In the construction contracts, include a provisional assignment of subcontracts, and require that the prime or CMAR obtain the subcontractors' prior consent to the assignment of their subcontracts to the owner. A conditional assignment of this sort has been in the AIA A201 form for some years now. The forms for construction and construction management

published and used by the State Construction Office, however, do not contain this sort of provisional assignment (forms OC-15 and OC-15/CM).

- Include an effective termination for convenience clause. The State Construction Office OC-15 forms do not provide for termination for convenience. The AIA Doc. A201 has a clause titled termination for convenience, but it provides no real benefit to the owner:

§ 14.4.3 In case of such termination for the Owner's convenience, the Contractor shall be entitled to receive payment for Work executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.

- With an effective termination for convenience clause, one that allows the owner to terminate a contract and pay only the reasonable value of work in place, with no payment for the contractor's lost profit, the risk of liability for unjustified termination is largely removed.
- Look closely at your performance bond. Some of the standard forms circulating in the industry give the surety considerable control over the project when a contractor defaults, and considerable control over the process of negotiating relief under the bond. Generally avoid bonds that contain extensive notice provisions, meeting requirements, cure periods and options for the surety. No industry standard form bonds give the owner unfettered discretion to hire a replacement contractor after due notice to the surety.

Most projects go well. When they do not go well, hopefully your contract will have some of these clauses providing you with more negotiating leverage with the designer or contractor.