



Litigating & Negotiating Construction Contracts

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About The Speaker

James T. Rohlfiing is an Illinois attorney and principal of the Chicago law firm of Rohlfiing & Oberholtzer. His boutique law firm focuses its practice in the areas of construction law, mechanics liens and business litigation.

Mr. Rohlfiing is the co-editor and a chapter author of the treatise Rohlfiing & Franco, Illinois Construction Law Manual, published by West. Since being admitted to the Illinois bar in 1982, Mr. Rohlfiing has represented subcontractors, contractors and others in the construction industry. He has conducted dozens of trials and appeals involving business litigation and construction law, and successfully resolved hundreds of related legal matters for his clients. He routinely represents his clients in contract negotiations and advises them on operating issues arising in their businesses. He has been instrumental in drafting Illinois legislation critical to subcontractors and contractors and the construction industry in general. He has frequently provided written materials and testimony to the Illinois legislature with respect to bills concerning the Illinois Mechanics Lien Act and other construction related laws. In addition, he has authored numerous articles on construction law and litigation, and is often invited to speak on commercial litigation and construction law topics before construction industry groups and practicing attorneys.

Mr. Rohlfiing has served as president of the Illinois Mechanical & Specialty Contractor's Association (IMSCA), the largest and most effective organization for subcontractors in Illinois. He is an active member of IMSCA, the Chicago Bar Association's Construction Law committee, the Association of Subcontractors and Affiliates in Chicago and the Commercial Law League of America.

Prior to founding Rohlfiing & Oberholtzer, Mr. Rohlfiing was a partner at two Chicago business law firms where he directed their litigation departments. He received his Bachelor of Science in Business Administration in 1979 from Marquette University and his Juris Doctorate from DePaul University College of Law in 1982. At DePaul he was published in the law review.

Jim is a Martindale-Hubbell AV rated attorney.

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By James T. Rohlfing, Rohlfing & Oberholtzer

I. INTRODUCTION

This is an introduction to the most commonly used construction contract forms, which are published by the American Institute of Architects (“AIA”) with a focus on five key issues covered in those form contracts - issues that are often discussed in negotiation or the subject of litigation arising out of construction contracts. The purpose is to introduce the basic construction contract provisions and to demonstrate how particular construction contract clauses operate to shape and define the litigation issues that arise upon breach.

A. Use of Form Construction Contracts

Construction, especially commercial construction and other larger construction projects, is multi-faceted, requires significant human interaction and varies greatly from one project to another. These attributes contribute to the need for comprehensive written contracts that clearly spell out the rights and obligations of the parties. Though there are many differences between projects, as well as different types of work and dissimilar laws from one state to another, there are also many similarities repeatedly encountered on most construction projects. Therefore, the use of form contracts with many of the same provisions from one contract to another are a practical means to save time and increase the likelihood of covering the essential issues that should be included in the contract.

There are many forms available for documenting agreements to perform construction work, published by a variety of organizations, including the American Institute of Architects (“AIA”), Associated General Contractors of America (“AGC”), ConsensusDOCS, published by a coalition of industry groups, the Engineers Joint Construction Documents Committee (“EJCDC”), and the

Associated Owners & Developers (“AOD”). The trade associations that draft and revise the forms do so with the perspective of their own constituents. For example, though the AIA forms are somewhat more even handed than most others, they are still more sympathetic to architects than some other forms. In any event, whatever form is used, the parties should recognize the limitations and amend them as appropriate. Modifications might be suitable for various reasons, such as to conform to specific state laws, to fit unique projects, to accommodate unusual attributes of the parties or, most commonly, to reflect the leverage of the parties.

Nonetheless, having a basic understanding of several key issues that are often discussed at the negotiation stage or litigated in troubled projects can be valuable to attorneys confronted with the task of negotiating or litigating construction contracts. This discussion will reference a handful of key provisions in the 2007 Edition of the AIA A201 Document known as the “General Conditions of the Contract for Construction.” The A201 is not a freestanding agreement, but provides supplementary terms for other AIA documents such as the Agreement between Owner and General Contractor, AIA A101. The AIA family of forms includes many other forms as well, but these are the most commonly used and most of the others also incorporate the A201.

B. The Law of Contracts

An analysis of construction contracts begins with the study of contract law. Though the common law of contracts differs from one state to another, the common law tends to be more consistent than applicable statutory schemes. For example, mechanics lien laws differ greatly from one state to another. The UCC applies if the work is predominantly the supply of materials, though more frequently, common law will apply because most construction contracts are predominantly for the furnishing of services. In addition, there are many other state laws that apply to such contracts depending upon the nature of the job, the identity of the contracting parties, and other factors. These laws include state

and federal wage and hour laws, state and federal bond statutes, and consumer protection statutes of one sort or another.

Using standard form contracts usually will alleviate concerns over basic contract formation issues, such as offer, acceptance and consideration. Nonetheless, clients often benefit from a reminder that if their negotiations included points not covered in the form contract, the points must be inserted in the form contract or in an attached rider. They should be advised that if the contract does not include those issues, the parole evidence rule may prevent them from relying on the pre-contract negotiations. One additional issue that always seems worth special mention is a discussion about what documents are considered to be the “contract.” It is common for contracts to incorporate other documents by reference (via an “integration clause”) and those documents might not be made available for review and if they are, they might not be read before signing the contract. Failing to read incorporated documents will not be a defense to the provisions in that document. See, e.g., *Cleveland Wrecking Company vs. Central National Bank of Chicago*, 216 Ill.App.3d 279 (1991).

C. AIA Form Construction Contracts

AIA forms are clearly written, cleanly printed, logically organized and fairly easy to understand. The forms have been in use for approximately one hundred years and they are updated with input from divergent construction industry associations every ten years. The major forms were last updated in 2007. Attorneys who practice construction law are often more familiar with the AIA forms than they are with others, and they know what they are getting and what is expected of their clients under these contracts. As a result, using them often reduces attorney review and negotiating time. Also, they offer an air of legitimacy, because people tend to believe they are authoritative, unlike a form that is custom made to protect the interests of only one side to the deal. Indeed, compared to most of the standardized forms in common use, the AIA is less one-

sided to any of the participants in the process, though they do still tend to favor the owner and architect.

Though the AIA forms are usually modified in some respects, it is not uncommon to see them largely unchanged from the form document. Subcontractors, who, by some measures, are least protected by the AIA form construction contracts might propose a rider be added to the form subcontract. A copy of a rider used by some subcontractors is attached as an example. Of course, this is merely an example and must be modified to fit specific circumstances.

One additional advantage to the AIA forms is that many of their provisions have been in use long enough to give courts time to develop case law construing their meaning. Fortunately, there is an abundance of sources discussing the meaning and purpose of the AIA construction contract forms and collecting cases that have construed portions of those contracts. Two treatises that compile court cases construing AIA construction contract provisions as well as cases that relate to those provisions are: Steven Stein, The American Institute of Architects Legal Citor, 2011 Edition LexisNexis; Steven Stein, Construction Law, LexisNexis, 2010. Other books discuss the meaning and intent of the drafters, alternative form contracts and direct the readers to illustrative cases. See, Justin Sweet, Sweet on Construction Industry Contracts: Major AIA Documents, 4th ed. 1999 Aspen Law & Business; Werner Sabo, Legal Guide to AIA Documents, 4th ed., Aspen Law & Business. Other treatises on construction law include chapters devoted to the AIA construction contracts. See, e.g., Rohlfing and Franco, Illinois Construction Law Manual, chpt. 6, West, 2009.

AIA contract forms are available for purchase online. They may be purchased individually, but most people who intend to use them more than once or twice purchase a limited or unlimited annual license for the software. The documents are modifiable through Microsoft Word or other word processing

programs. Putting aside some glitches from a zealous effort to prevent theft of their copyright, the software is fairly easy to use. In addition to the three most common documents mentioned below, there are contract documents for architects, contracts for smaller projects, specific types of projects, and contracts to accommodate other types of construction delivery systems, such as design-build, or when a construction manager is used. There are also incidental documents, such as change orders, architect certifications, and payment applications. The use of the proper complimentary forms with each other decreases the likelihood of ambiguities that might otherwise arise from internally inconsistent contract provisions. Using current forms, rather than older editions, is another way of avoiding the potential for internal inconsistencies among the contract documents.

As you would expect, the AIA form contracts cover all of the essential elements of an agreement to perform a complicated task, including, in the case of a contract between the owner and general contractor: 1) the rights and duties of the owner and contractor; 2) a description of the work to be performed; 3) payment for the work; 4) the role of the architect, subcontractors and others; 5) warranties; 6) scheduling the work; 7) indemnification; 8) insurance; 9) changes in the work; 10) safety concerns; 11) contract termination; and 12) claims and disputes. These essential elements and others are included in most form construction contracts.

D. Select Forms and Issues

To make this discussion more meaningful, the focus will be on: 1) Changes under the contract; 2) Differing site conditions; 3) Delay and other timing issues; 4) Payment issues; and 5) Contract termination. These five issues arise frequently in negotiating or litigating construction contracts. Because clients play a larger role and the perspective is different in the contract negotiations, the issues that arise then are often different than those that tend to get litigated. A client's negotiating priorities usually are not limited to the best protection of their

interests in litigation, because: 1) contracts affect the job in ways other than influencing the outcome in the event of litigation; 2) negotiating attorneys may not be as concerned or understanding of the priority of litigation oriented provisions; and 3) the parties and their attorneys usually don't anticipate litigation at the beginning of a project but are instead concerned about how to make the job profitable and performance practical.

Though there are many AIA forms, the most commonly used forms for commercial construction projects are:

- i. The AIA A201 – General conditions of the Contract for Construction – though this is not a contract on its own, it contains the bulk of the “meaty provisions” and it is incorporated by reference in most of the AIA form contracts.
- ii. The AIA A101 – Standard Form of Agreement Between Owner and Contractor. This is the most commonly used form between owners and general contractors when there are plans and specifications provided by others. The basis for payment is usually a fixed sum, but can be another basis, such as cost of the work plus a fee.
- iii. The AIA A401 – Standard Form of Agreement Between Contractor and Subcontractor. This form is used between the general contractor and subcontractors. It typically incorporates the agreement between the owner and contractor, the general conditions of the contract for construction, plans and specifications, as well as other documents.

II. CHANGES

The description of the work the contractor or subcontractor is expected to perform is called the “scope of work”. The scope of work is frequently not completely settled when the project begins and even if it is it can be complex and is therefore a frequent source of contention on a construction project. Because

construction is a labor intensive pursuit, precisely defining the work to be performed is often a difficult task. Many factors cause a change or perceived change in scope. Determining the liability of the contracting parties for the costs that arise from changes in scope will depend on the reasons for the change, whether the change was properly documented, and the pertinent provisions of the contract.

A. Change Orders

The following provisions from the AIA A201 pertain to contract changes:

§ 7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor and Architect; a Construction Change Directive requires agreement by the Owner and Architect and may or may not be agreed to by the Contractor; an order for a minor change in the Work may be issued by the Architect alone.

§ 7.2 CHANGE ORDERS

§ 7.2.1 A Change Order is a written instrument prepared by the Architect and signed by the Owner, Contractor and Architect stating their agreement upon all of the following:

- .1 The change in the Work;
- .2 The amount of the adjustment, if any, in the Contract Sum; and
- .3 The extent of the adjustment, if any, in the Contract Time.

§ 7.3 CONSTRUCTION CHANGE DIRECTIVES

§ 7.3.1 A Construction Change Directive is a written order prepared by the Architect and signed by the Owner and Architect, directing a change in the Work prior to agreement on adjustment, if any, in the Contract Sum or Contract Time, or both. The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, the Contract Sum and Contract Time being adjusted accordingly.

§ 7.3.2 A Construction Change Directive shall be used in the absence of total agreement on the terms of a Change Order.

Many lawsuits arise out of misunderstandings concerning change orders and change orders are, accordingly, a fruitful source for construction litigation. Change orders require agreement between the owner, architect and the contractor. Construction change directives do not require agreement from the Contractor, and the Contractor is obligated to perform the requested work prior to an agreement being formed. A so called “cardinal change” is one that materially expands the work beyond the existing scope. The distinction defies precise definition, but an owner could not, without the contractor’s consent, demand the building of a mall under a contract for the erection of a factory. The cases which have found “cardinal changes” have involved dramatic changes in the cost and scope of work in an order of magnitude of 60% or more.

The owner, however, would be able to insist on a change in specific materials or methods, increase or decrease the amount of materials, modify the time schedule or insist on other changes with merely a constructive change directive and not a change order. Article 7 of the A201 describes the means by which a price for a change is to be determined by the parties either before or after the work is done. Contractors and subcontractors would prefer to have agreement required for a change before the work is done, as they have more leverage at that time and arguably should only be required to perform the work if the price is fair in their estimation.

§ 7.4 MINOR CHANGES IN THE WORK

The Architect has authority to order minor changes in the Work not involving adjustment in the Contract Sum or extension of the Contract Time and not inconsistent with the intent of the Contract Documents. Such changes will be effected by written order signed by the Architect and shall be binding on the Owner and Contractor.

Small changes such as color or minor variations in the schedule or scope can be ordered by the architect without approval from the owner or contractor.

Changes to the contract are required to be in writing and without a written change order or written change directive, a contractor or subcontractor is not authorized to do the work. The majority opinion seems to be that the requirement that change orders be in writing may be waived by the conduct of the parties. See, e.g., *Custom Builders, Inc. v. Clemons*, 52 Ill.App.3d 399, 367 N.E.2d 537 (3rd Dist. 1977). In Illinois, waiver must be shown by clear and convincing evidence. *Id.* Other courts impose different requirements.

Without a requirement that change orders be in writing, contractors face a significant risk on nonpayment when misunderstandings arise over what was requested, while owners might be required to pay for work not ordered. Significantly, the practice in construction is to perform the work based on an owner's oral request, even with a contract that requires a written change order. Contractors who delay performing orally requested change orders to await a written notice are disfavored for hiring on the next project by that owner. Contractors who delay a job because they insist on a formal written change order for every little modification to the scope or schedule will lose work because they will frustrate the owner with delayed performance. They also risk being blamed for a delay. In reality, documenting the request for change in writing with emails, or otherwise is the more practical solution for smaller changes, while larger ones do merit more formality.

Thus, the language and existence of contract clauses with respect to change orders will have an important impact on the nature and the outcome of litigation that arises in the event of a dispute over change orders. Issues that are often in dispute include: i) what are the contract terms; ii) was the alleged change a change in scope or just a reasonable extension of terms already defined in the contract which should have been included in the original contract price; iii) were the change order approval procedures followed or were they waived, especially by a pattern and practice of the parties; iv) is a party estopped from relying on the

change order procedures; and v) how is the value of the alleged change to be calculated?

III. SITE CONDITIONS

A. Duty to Inspect

In the process of bidding the project, the contractor must attempt to accurately ascertain its expected costs, which includes a review of the site conditions where the work will be done. Work at an older building or in a floodplain poses more risk than erecting a new building on soil with known subsurface conditions. Section 3.2.1 of AIA A201, a contractor must either visit the site and observe surface conditions or take the risk that they are different than expected.

§ 3.2.1 Execution of the Contract by the Contractor is a representation that the Contractor has visited the site, become generally familiar with local conditions under which the Work is to be performed and correlated personal observations with requirements of the Contract Documents.

B. Concealed Conditions

One of the big uncertainties in the construction process is not knowing what will be encountered below the surface or in the case of an older building, what will be hidden within the structure. Though the contractor could alleviate some of the risk by hiring experts to inspect such conditions, such tests are expensive and often inconclusive. Sometimes an owner will furnish information to the contractor about the hidden conditions but the owner will often disclaim any responsibility for the accuracy of the information. Section 2.2.3 of the A201 requires the owner to furnish very basic information and it permits the contractor to rely upon it.

§ 2.2.3 The Owner shall furnish surveys describing physical characteristics, legal limitations and utility locations for the

site of the Project, and a legal description of the site. The Contractor shall be entitled to rely on the accuracy of information furnished by the Owner but shall exercise proper precautions relating to the safe performance of the Work.

A contractor may choose to rely on information from the owner describing subsurface conditions which is disclaimed and perhaps increase its bid to account for the increased risk. Another method for dividing the risk is to adjust the contract price if an unknown site condition is encountered that increases the cost of performing the project.

§ 3.7.4 Concealed or Unknown Conditions. If the Contractor encounters conditions at the site that are (1) subsurface or otherwise concealed physical conditions that differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, that differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, the Contractor shall promptly provide notice to the Owner and the Architect before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if the Architect determines that they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall promptly notify the Owner and Contractor in writing, stating the reasons. If either party disputes the Architect's determination or recommendation, that party may proceed as provided in Article 15.

The AIA A201 permits a contractor to recover costs incurred due to unforeseen site conditions, while some other form contracts put all the risk on the contractor. The requirement of the contractor to furnish prompt notice when it learns of an unforeseen condition, however, should not be overlooked. See, e.g., *North*

Harris County Junior College District v. Fleetwood Construction Co., 604 S.W.2d 247 (Tex. Civ. App. 1980). Moreover, even if: 1) the concealed conditions were genuinely unforeseeable; 2) they increased the cost of the work; and 3) proper notice was given - the contractor must decide whether to perform the work without a change order from the owner and run the risk of objection and nonpayment.

C. Site conditions as a basis for dispute

Given the practical constraints of the bidding process, the litigation potential of site inspection and site condition clauses is apparent. Potential contract bidders operate under severe time constraints, and they are under pressure to submit the lowest possible bid to become the successful bidder. As a general rule, potential bidders will not be compensated for destructive or invasive pre-bid testing at the job site; there is no time to do the testing; and they are often not given permission to conduct the tests anyway. Thus, when a construction job involves excavation or renovation of existing structures and the owner imposes a site inspection or site condition clause which either forces the contractor to assume all risks or substantially reduces or interferes with a contractor's right to collect for changed conditions, the likelihood of subsequent claims for breach increases accordingly.

Again, the contract terms define the conflict: i) did the owner know or should he have known of the condition; ii) was there fraud; iii) was the condition foreseeable or unforeseeable; iv) were the contract's notice procedures followed or waived; v) is the owner estopped from relying on the clause; vi) does the condition render contract performance impossible or commercially impracticable; and vii) how is the value of the changed condition to be calculated in terms of time and money?

IV. DELAY

A. Time for completion

The AIA A101 and other AIA contract forms provide a blank in which to insert the date when the work is to commence and, absent a designated date, they provide that the date of commencement shall be set forth in a notice to proceed issued by the owner. Section 3.10.1 of AIA A201 provides that the contractor shall furnish a schedule indicating when certain portions of the work shall be completed and section 3.10.3 obligates the contractor to perform the work in accordance with the schedule.

§ 3.10.1 The Contractor, promptly after being awarded the Contract, shall prepare and submit for the Owner's and Architect's information a Contractor's construction schedule for the Work. The schedule shall not exceed time limits current under the Contract Documents, shall be revised at appropriate intervals as required by the conditions of the Work and Project, shall be related to the entire Project to the extent required by the Contract Documents, and shall provide for expeditious and practicable execution of the Work.

The time for substantial completion of the work, pursuant to section 8.1.3 of the A201 is the date certified by the Architect. Substantial Completion is defined as "the stage in the progress of the Work or when the Work or designated portion thereof is sufficiently complete in accordance with the Contract Documents so that the Owner can occupy or utilize the Work for its intended use." A201, Art. 9.8.1. Final Completion is achieved when the Project is ready for final inspection upon receipt of a final application for payment. A201, Art. 9.10.1.

Pursuant to Section 8.2.1, time is of the essence of the contract, and under section 8.2.3, the Contractor must proceed expeditiously in order to achieve Substantial Completion within the contract time.

§ 8.2.1 Time limits stated in the Contract Documents are of the essence of the Contract. By executing the Agreement the Contractor confirms that the Contract Time is a reasonable period for performing the Work.

§ 8.2.3 The Contractor shall proceed expeditiously with adequate forces and shall achieve Substantial Completion within the Contract Time.

Change orders may provide for an extension of the schedule if the additional work would require more time. The contractor has the responsibility of scheduling the work of the subcontractors and its own work force to assure timely performance. The owner is required to provide access to the site in such condition that would make it possible for the contractor to perform its work. The contractor must update the schedule to reflect the reality of the progress of the work as it is underway.

Therefore, it is important to realize that changes in scope or changes in site conditions frequently impact the construction schedule, completion dates, construction financing, and potential damages claims. Each of those changes has the capacity to change the entire organic structure of the parties' contract documents. If the parties permit changes to their contract without adequately considering and resolving the construction scheduling issues inherent in any change order or changed condition, they may only be postponing that discussion to a time when it is raised in litigation.

B. Delay

Sometimes, especially on smaller projects, taking a little extra time to finish the job is relatively unimportant to the owner or contractor. On larger projects, however, the time it takes to complete the work might be of great importance to both the owner and the contractor. From the owner's perspective, if the work is not completed by the agreed completion date, the owner will be unable to use the building or other structure when he had intended. In addition, some costs of the construction process are frequently borne by the owner, and

financing can be jeopardized by delays while interest on the construction loan will continue to accumulate. From a contractor's perspective, if the work was bid with the understanding that it would be performed efficiently within a certain time frame, changing the schedule can be devastating to a project's profitability. Compressing the schedule and accelerating the work might require excess overtime pay and much inherent inefficiency. When the contractor's work force and equipment are unavailable for other projects, significant costs are involved.

The owner and contractor each want to be compensated for damages caused by the other's delay, but they also both want protection from damage delay claims that might be brought by the other party. For these reasons, delay clauses are often the subject of negotiation discussions when the contract is formed and, because delay is common in construction, they are frequently the focus of litigation when the schedule has been disrupted.

Under the AIA documents, if an owner delays a contractor's work, the contractor is entitled to an extension of time within which to complete the work without liability for delay damages. The architect is charged with making the determination initially, subject to arbitration or litigation if there is disagreement.

§ 8.3.1 If the Contractor is delayed at any time in the commencement or progress of the Work by an act or neglect of the Owner or Architect, or of an employee of either, or of a separate contractor employed by the Owner; or by changes ordered in the Work; or by labor disputes, fire, unusual delay in deliveries, unavoidable casualties or other causes beyond the Contractor's control; or by delay authorized by the Owner pending mediation and arbitration; or by other causes that the Architect determines may justify delay, then the Contract Time shall be extended by Change Order for such reasonable time as the Architect may determine.

Claims for an extension of time must meet the requirements for a claim set forth elsewhere in the contract documents.

§ 8.3.2 Claims relating to time shall be made in accordance with applicable provisions of Article 15.

Thus, the claims must be made in a timely manner; claims not made within the time requirements of the contract may be denied on that basis, even though it would otherwise be allowed. *See, e.g., A.H.A. Gen. Constr., Inc. v. New York City Hous. Auth.*, 92 N.Y.2d 20, 699 N.E.2d 368 (1998) (N.Y. Court of Appeals) sustained summary judgment for owner denying contractor's claim for extra work when it failed to comply with notice requirement); *Starks Mech., Inc. v. New Albany-Floyd County Consol. Sch. Corp.*, 854 N.E.2d 936 (Ind. Ct. App. 2006) (contractor's delay claim denied per 8.3.2 when it failed to provide timely written notice to owner).

Under section 8.3.3 both the owner and contractor are also entitled to recover for any damages they incur due to a delay by the other party.

§ 8.3.3 This Section 8.3 does not preclude recovery of damages for delay by either party under other provisions of the Contract Documents.

Under common law, absent a contract provision to the contrary, a contractor can recover damages for acts or omissions of the owner, which burden the performance of the work and increase the costs of completion. *See, e.g., Bates & Rogers Construction Corp. vs. North Shore Sanitary District*, 92 Ill.App.3d 90 (1980); *Amp-Rite Electric Company, Inc. vs. Wheaton Sanitary District*, 220 Ill.App.3d 130 (1991).

It is standard practice, however, to add a "no damage for delay" clause to construction contracts. This means that the delayed party is entitled only to an extension of time, but not to extra money for items like increased costs or higher labor rates. Some cases have held, however, that an owner cannot insulate himself from monetary damages if he is the party responsible for the delay. *See,*

e.g., *Bates and Roger's Construction Corp. v. North Shore Sanitary Dist.*, 92 Ill. App. 3d 90, 414, N.E. 2d 1274, 1279 (2d Dist. 1980). The "no damages for delay" clause only allows for a commensurate extension of time. The purpose of the "no damage for delay" clause is to protect the owner against delay claims for which the owner has not budgeted. Contractors and subcontractors, however, believe that if delay is encountered through no fault of their own and it increases the cost to perform, they should be compensated accordingly.

These clauses are strictly construed against the party attempting to enforce them. *Gust K. Newberg, Inc. v. Illinois State Highway Authority*, 153 Ill. App. 3d 918, 506 N.E. 2d, 658 (2d Dist. 1987). Under Illinois law, "no damages for delay" clauses will not be enforced when: 1) a party is guilty of bad faith, fraud, concealment, misrepresentation or hindrance; 2) where the delay was not within the contemplation of the parties when the contract was entered into; 3) where the delay is unreasonable in duration; or 4) where the delay is attributable to the inexcusable ignorance or incompetence of another party. *J&B Steel Contractors, Inc. vs. C. Iber & Sons, Inc.*, 162 Ill.2d 265 (1994); *Bates and Rogers Construction Corp., Supra*. Other courts have held that delay damages are recoverable if they were not within the contemplation of the parties. See, *Atlantic Coast Mech v. R.W. Allen Beers Constr.* 264 Ga.App. 680, 592 S.E.2d 115 (2003)(subcontractor entitled to recover delay damages despite "no damage for delay" provision in general contract, which was incorporated by reference, as delays encountered exceeded those contemplated by the parties). In New York, the clauses may be enforced unless the contractor demonstrates gross negligence or willful misconduct by the owner. See, e.g., *Kalisch-Jarcho, Inc. v. City of New York*, 58 N.Y.2d 377, 488 N.E.2d 413 (1983) ("no damage for delay" clause was enforceable unless contractor could show owner caused long delays and owner's conduct amounted to gross negligence); *Corinno Civetta Constr. Corp. v. City of New York*, 67 N.Y.2d 297, 493 N.E.2d 905 (1986) (to recover in face of no damage for delay clause, contractor must show owner's conduct was grossly negligent or willful conduct).

Many construction contracts provide for liquidated damages in the event of delay because it can be very difficult to prove the amount of damages caused by delay. Such provisions are enforceable if they are a reasonable estimation of damages and not a penalty. See, e.g., *Grossinger Motorcorp, Inc. v. American National Bank and Trust Co.*, 240 Ill.App.3d 737, 749 (1992). Without a liquidated damage provision, proving delay damages at trial is usually a complicated and time-consuming process involving expert witnesses.

V. PAYMENT ISSUES

A. Payment Procedures

Payment is sometimes the only issue of concern to optimistic clients. Rightly or wrongly, the other matters are considered of little consequence, but how and when payment will be made is vital. The payment amount for a fixed sum contract is usually determined before the attorney is involved. Usually, on larger projects, the procedures followed for making and obtaining payments are fairly uniform, with draw requests to be made once a month, followed by payments within some set number of days thereafter.

The following are key payment provisions in the AIA A102:

§ 9.1 CONTRACT SUM

The Contract Sum is stated in the Agreement and, including authorized adjustments, is the total amount payable by the Owner to the Contractor for performance of the Work under the Contract Documents.

§ 9.2 SCHEDULE OF VALUES

Where the Contract is based on a stipulated sum or Guaranteed Maximum Price, the Contractor shall submit to the Architect, before the first Application for Payment, a schedule of values allocating the entire Contract Sum to the various portions of the Work and prepared in such form and supported by such data to substantiate its accuracy as the Architect may require. This schedule, unless objected to by

the Architect, shall be used as a basis for reviewing the Contractor's Applications for Payment.

§ 9.3 APPLICATIONS FOR PAYMENT

§ 9.3.1 At least ten days before the date established for each progress payment, the Contractor shall submit to the Architect an itemized Application for Payment prepared in accordance with the schedule of values, if required under Section 9.2., for completed portions of the Work. Such application shall be notarized, if required, and supported by such data substantiating the Contractor's right to payment as the Owner or Architect may require, such as copies of requisitions from Subcontractors and material suppliers, and shall reflect retainage if provided for in the Contract Documents.

Usually, the payment application process is well known to contractors and subcontractors who happily follow requirements established by title companies to obtain interim and final payments.

B. Pay if Paid

Subcontracts frequently contain "pay when paid" or "pay if paid" provisions. A pay when paid clause controls the timing of when a general contractor must pay a subcontractor, typically requiring payment a set number of days after the general contractor receives payment from the owner. A "pay if paid" clause can relieve a general contractor of its obligation to pay a subcontractor in the event the general contractor is not paid by the owner. The majority of states enforce such provisions, though a sizeable minority does not. Illinois courts enforce them if they are abundantly clear. See, e.g., *A.A. Conte, Inc. v. Campbell-Lowrie, Lautermilch Corp.*, 132 Ill. App.3d 325, 477 N.E.2d 30 (1st Dist. 1985). In Illinois, if the reason the owner is not paying is solely the fault of the general contractor, then a pay if paid clause will not be a defense for a general contractor to not pay a subcontractor. *Standard Asbestos Mfg. v. Kaiser*, 316 Ill. App. 441, 45 N.E.2d 75 (1st Dist. 1942 *abst.*).

The enforceability of “pay-if-paid” clauses often involves questions of both law and fact. As a condition precedent to payment they are viewed unfavorably, and therefore, a party seeking to enforce such a clause will lose its protection by acting or failing to act in a manner that fails to bring about the condition. For example, if a general contractor settles its claims with an owner for less than the total face value of the claim amounts sought by its subcontractors without the subcontractors’ prior approval, the general may find itself liable to its subcontractors to the full extent of their claims. In short, “pay when paid clauses” impose a duty of good faith and fair dealing on the party enjoying the protection of such clauses which that party may find it difficult to meet.

C. Prompt Payment Acts

All the states and the Federal government have some form of prompt payment law, at least for public projects. Usually these laws require payment to be made to a contractor within a certain number of days following invoice and if payment is not made, the general contractor is entitled to interest and sometimes attorneys’ fees and other remedies as well. Most of the states that have such laws provide similar protections for subcontractors in the event they are not paid by general contractors. Approximately half of the states have some form of prompt payment law that provides remedies to contractors and subcontractors in the event they are not paid in a timely manner on a private project. See, “The National Prompt Pay Digest,” NCS Construction Services Group (2003). Though they vary from state to state, usually these laws will take precedence over contrary provisions in a construction contract. As an example, the Illinois Prompt Payment law is attached.

Most construction contracts provide for retention to be withheld by an owner of five to ten percent. A majority of states have some laws restricting retention that may be withheld on public contracts and a sizeable minority has laws restricting the retainage that may be withheld on private projects. See, “Retainage Laws in the 50 States,” Foundation of the American Subcontractors

Association, Inc. (2008). A bill to restrict retainage on Illinois construction projects to five percent was introduced this year in the Illinois legislature.

VI. CONTRACT TERMINATION

Both the Owner and the Contractor are permitted to terminate the Contract under certain circumstances as described in Article 14 of the AIA A201. Absent a basis for termination, however, both parties are obligated to continue with the contract until the work is completed and the contractor is paid.

A. Contractor's Termination

A contractor's bases for termination are set forth in Section 14.1.2.

§ 14.1 TERMINATION BY THE CONTRACTOR

§ 14.1.1 The Contractor may terminate the Contract if the Work is stopped for a period of 30 consecutive days through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, for any of the following reasons:

- .1 Issuance of an order of a court or other public authority having jurisdiction that requires all Work to be stopped;
- .2 An act of government, such as a declaration of national emergency that requires all Work to be stopped;
- .3 Because the Architect has not issued a Certificate for Payment and has not notified the Contractor of the reason for withholding certification as provided in Section 9.4.1, or because the Owner has not made payment on a Certificate for Payment within the time stated in the Contract Documents; or
- .4 The Owner has failed to furnish to the Contractor promptly, upon the Contractor's request, reasonable evidence as required by Section 2.2.1.

Additional bases for contractor termination are described in Article 14, including that the time expended to perform has increased by 100% of the original time or that the work is stopped by more than 60 days through no fault of the contractor.

If the contractor terminates for a permissible reason, upon seven days notice, he is entitled to “recover from the Owner payment for Work executed, including reasonable overhead and profit, costs incurred by reason of such termination, and damages.” Section 14.1.3.

B. Owner's Termination

An Owner also may terminate the contract, for cause or for convenience.

§ 14.2.1 The Owner may terminate the Contract if the Contractor

.1 repeatedly refuses or fails to supply enough properly skilled workers or proper materials;

.2 fails to make payment to Subcontractors for materials or labor in accordance with the respective agreements between the Contractor and the Subcontractors;

.3 repeatedly disregards applicable laws, statutes, ordinances, codes, rules and regulations, or lawful orders of a public authority; or

.4 otherwise is guilty of substantial breach of a provision of the Contract Documents.

If termination for cause is justified by the contract, then after notice, the owner may take assignment of any subcontracts and finish the work. Once the work is finished, if the unpaid balance of the contract exceeds what it cost to finish the work, then the balance shall be paid to the contractor. If the balance due on the contract is less than what it cost to finish the work, then the contractor shall pay the owner the difference. The cost to finish the work almost always exceeds the balance due on the contract to the contractor. A common source of dispute is whether the costs to finish were justified. The owner must account for the costs incurred, and to recover the contract balance, the contractor must be able to show the expenses incurred by the owner were excessive or unrelated to the original scope of work.

The owner may also terminate for convenience, and he need not demonstrate that any cause exists to do so. The measure of damages includes the contractor's overhead and profit if termination was for convenience.

§ 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.

VII. CONCLUSION

The judicious use of AIA form contracts can be a practical means of documenting an agreement to perform construction work. Attention to the key provisions discussed above can greatly reduce the likelihood of litigation when misunderstandings occur in the construction process or, at least, position your client for a more favorable outcome in the unwanted dispute.

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RIDER TO AGREEMENT BETWEEN
CONTRACTOR AND SUBSUBCONTRACTOR

(Favorable to Subcontractor)

James T. Rohlfig©

This is a Rider to that certain Agreement dated _____, 20__ (“Contract”), by and between Goliath Contractor, Ltd. (“Contractor”) and David the Painter, Inc. (“Subcontractor”) dated the same date as this Rider, for a project known as “The Hospital” (the “Project”). In the event of any conflict or inconsistency between the provisions of this Rider and the provisions of the Contract, the provisions of this Rider shall govern.

1. The Contract is amended to provide that any obligations of Subcontractor under the Written Agreement between the Owner and the Contractor, including any and all exhibits, attachments and general conditions (the “Prime Agreement”) relate solely to the Subcontractor’s scope of work as described in the Contract and the Subcontractor is not required to perform additional work under the Prime Agreement that is not expressly described in this Contract as Subcontractor’s scope of work.

2. Each and every duty and obligation of the Owner to the Contractor under the Prime Agreement shall likewise be duties and obligations of the Contractor to the Subcontractor under this Contract. Further, each and every right, action or remedy of the Contractor with respect to the Owner pursuant to the Prime Agreement shall be a right, action or remedy of the Subcontractor under this Contract. Moreover, the Contractor shall make and guarantee to Subcontractor, each and every representation, warranty and guaranty that the Owner is obligated to make to Contractor under the Prime Agreement.

3. No terms and conditions or other document included by reference in the Contract shall be binding on the Subcontractor unless a copy thereof has been furnished to the Subcontractor prior to signing the Contract.

4. Section __ is amended to provide that payments shall be made by Contractor no later than fourteen (14) days from receipt of payment from the Owner. Further, Contractor shall not hold any retainage from Subcontractor and any reduction in retainage held by the Owner shall be promptly remitted to Subcontractor.

5. Subcontractor shall be entitled to compensation for overtime requested by the Contractor and for damages incurred by Subcontractor related to disruptions or delays in Subcontractor's work.

6. Subcontractor does not waive its entitlement to be paid by Contractor for its work and expenses under the Contract due to the failure of the Owner to pay Contractor, unless the reason for nonpayment from the Owner is due to a breach of the Contract by Subcontractor. Payments made to the Contractor for the benefit of the Subcontractor shall be paid to the Subcontractor without deduction of any amounts for Contractor's profit, overhead and other charges.

7. Subcontractor's failure to furnish any notice of claim or other notice as provided in the Contract, within the period set forth in the Contract shall not waive Subcontractor's right to payment of said claim or other right, except to the extent that Subcontractor's untimely notice clearly prejudices the Contractor's rights.

8. Subcontractors of the Subcontractor shall be paid from payments received by Subcontractor from the Contractor. It shall not be necessary for

Subcontractor to furnish unconditional waivers from its Subcontractors prior to receiving payment from Contractor for those Subcontractors.

9. The provisions of the Contract regarding indemnification, hold harmless, assumption of risk and obligation to defend shall be reciprocal as between the parties so that the same protections afforded by Subcontractor to Contractor shall also be afforded by Contractor to Subcontractor. In no event shall Subcontractor be obligated to indemnify any party except for damages caused by Subcontractor's own negligence.

10. Subcontractor shall not be required to perform any extra work or Additional Services until the parties have agreed in writing upon the price to be paid Subcontractor for said work. Whether an item is beyond the scope of this Contract shall be determined by the Subcontractor.

11. The Contractor shall discover and give prompt notice to Subcontractor of any inconsistencies or defects in the design, drawings, specifications or other Contract Documents.

12. No payments may be withheld from Subcontractor unless and to the extent that such payment is: a) withheld by Owner from Contractor; b) based on a breach or purported breach of the Contract by the Subcontractor; c) supported by written evidence supplied by third party claimants; and d) following a ten day written notice to Subcontractor without a cure by Subcontractor.

13. The requirement of the Contract obligating the Subcontractor to pay the Contractor's insurance policy deductible shall only be effective if and to the extent the damages are determined to be the fault of the Subcontractor.

14. In any litigation arising under or related to the Contract, the prevailing party shall be entitled to recover its costs of litigation, including reasonable attorneys' fees, from the non-prevailing party.

15. The Contractor shall have no right to withhold payments due to the Subcontractor under the Contract, unless the Subcontractor has materially breached the Contract and said breach has not been cured after fifteen days written notice and, the amount withheld shall not exceed the amount of Contractor's claimed damages.

16. The Subcontractor shall not be liable for any liquidated, incidental or consequential damages, nor shall Subcontractor be liable for paying the Contractor's or any other parties' attorneys' fees or litigation expenses except as expressly provided in this Rider.

17. The Subcontractor may furnish proprietary and confidential information to the Contractor including, but not limited to, ideas, information, know-how, methods, trade secrets, designs and plans relating to systems designed by Subcontractor for preservation of existing structures and materials (the "Confidential Information"). All of the Confidential Information disclosed to the Contractor, either by the Subcontractor or its officers, agents and employees, is of a confidential nature and proprietary to the Subcontractor. The Contractor shall hold all Confidential Information in trust and confidence and will not furnish or divulge any of the Confidential Information to a third party except as expressly provided herein. The Contractor shall exercise reasonable care to prevent disclosure of the Confidential Information. The Contractor may only use the Confidential Information for the sole purpose of performing work on the Project and shall not exploit or attempt to exploit it for its own private benefit or for the benefit of others.

IN WITNESS WHEREOF, this Rider has been executed by the parties and is effective as of _____, 20__.

Goliath Contractor, Ltd.

David the Painter, Inc.

By: _____

By: _____

Its: _____

Its: _____

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West's Smith-Hurd Illinois Compiled Statutes Annotated
Chapter 815. Business Transactions

→ [Act 603](#). Contractor Prompt Payment Act
→ **603/1. Short title**

§ 1. Short title. This Act may be cited as the Contractor Prompt Payment Act.

603/5. Definitions

§ 5. Definitions. In this Act:

(a) “Payment application” means, in accordance with the terms and definitions of the applicable contract, any invoice, bill or other request for periodic payment, final payment, payment of change order or request for release of retainage from the contractor to the owner.

(b) “Construction contract” means a contract or subcontract, entered into after the effective date of this Act, for the design, construction, alteration, improvement, or repair of Illinois real property, except for contracts that require the expenditure of public funds and contracts for the design, construction, alteration, improvement, or repair of single family residences or multiple family residences with 12 or fewer units in a single building.

(c) “Contractor” and “subcontractor” shall have the meanings ascribed to them by the Illinois Mechanics Lien Act and cases decided under that Act.

603/10. Construction contracts

§ 10. Construction contracts. All construction contracts shall be deemed to provide the following:

(1) If a contractor has performed in accordance with the provisions of a construction contract and the payment application has been approved by the owner or the owner's agent, the owner shall pay the amount due to the contractor pursuant to the payment application not more than 15 calendar days after the approval. The payment application shall be deemed approved 25 days after the owner receives it unless the owner provides, before the end of the 25-day period, a written statement of the amount withheld and the reason for withholding payment. If the owner finds that a portion of the work not in accordance with the contract, payment may be withheld for the reasonable value of that portion only. Payment shall be made for any portion

of the contract for which the work has been performed in accordance with the provisions of the contract. Instructions or notification from an owner to his or her lender or architect to process or pay a payment application does not constitute approval of the payment application under this Act.

(2) If a subcontractor has performed in accordance with the provisions of his or her contract with the contractor or subcontractor and the work has been accepted by the owner, the owner's agent, or the contractor, the contractor shall pay to his or her subcontractor and the subcontractor shall pay to his or her subcontractor, within 15 calendar days of the contractor's receipt from the owner or the subcontractor's receipt from the contractor of each periodic payment, final payment, or receipt of retainage monies, the full amount received for the work of the subcontractor based on the work completed or the services rendered under the construction contract.

603/15. Interest; suspension of performance

§ 15. Interest; suspension of performance.

(a) If a payment due pursuant to the provisions of this Act is not made in a timely manner, the delinquent party shall be liable for the amount of that payment, plus interest at a rate equal to 10% per annum.

(b) A contractor or subcontractor who is not paid as required by this Act may, after providing 7 calendar days' written notice to the party failing to make the required payment, suspend performance of a construction contract without penalty for breach of contract, until the payment required pursuant to this Act is made.

(c) The interest imposed by this Act shall not be duplicative of the interest charged under the Mechanics Lien Act.

603/99. Effective date

§ 99. Effective date. This Act shall take effect upon becoming law.