The Pitfalls Associated with Construction Contracts

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A study conducted in 1994 by Florida International University, Department of Construction Management, concluded that one of the top three causes of problems on construction projects was the failure of participants, whether it be owner, contractor or subcontractor, to read and understand their contracts.

Consider the following scenario that actually occurred. A contractor meets with his lawyer and requests him to review a contract that requires the contractor to comply with the “monotony” code. Neither the contractor nor his counsel ever heard of this Code. They went so far as to contact local building departments and national organizations to inquire as to the origin and meaning of the “monotony” code. Finding no one that had ever heard of it, his client contacted the owner and asked what the “monotony” code was and where it could be found? In response, the owner indicated that neither he nor his counsel had ever heard of it. Following the above telephone call to the owner, all parties agreed to delete the reference from the contract.

This illustration sets the table for a discussion of pitfalls associated with construction contracting. As pointed out by the FIU study, participants to the construction process simply do not take the time nor expend the effort to understand what obligations are being undertaken pursuant to a written agreement.

Condominium associations, contractors and subcontractors have been quick to accept the forms developed by the American Institute of Architects (“AIA”) which publish standard forms of agreements to be used between owners and contractors, contractors and subcontractors, owners and design professionals, etc. Although readily accepted in the State of Florida, aspects of these documents fail to comply with Florida law. For example, the indemnification provisions set forth in the AIA agreement fails to recite a separate consideration as required by Section 725.06(2) and, therefore, would not be enforceable according to Florida law. In addition, these agreements contain provisions that cannot be readily understood. For example, the provision

governing warranties provides as follows: “The work will be free from defects not inherent in the quality required or permitted.” What does this provision mean? If we do not understand what the provision means, why do we sign agreements that include such provisions?

The AIA documents also incorporate by reference a document known as “A201 – General Conditions of Contract” which establishes general ground rules for performing work at a project dealing with matters such as insurance, warranties, statute of limitations, notice provisions, delays, and scope of responsibility for the various parties involved in the construction process. The pitfalls associated with the use of these documents can best be illustrated by a subcontractor that has contracted to perform work for a contractor using the A401 agreement between a general contractor and a subcontractor.

Following the subcontractor executing the A401 agreement with the contractor, he discovers that the contractor will be liable to the owner for liquidated damages amounting to $ 1,000 per day for each day of delay beyond the scheduled completion date. It is then discovered that the AIA document executed by the subcontractor contains a clause which incorporates the agreement between the owner and the contractor. Suddenly the subcontractor realizes he is on the hook for liquidated damages that the contractor is obligated to pay to the owner.

Then, upon careful review of the contract documents just signed, the subcontractor discovers that the AIA agreement contains a “pay when pay” clause, which simply means that the subcontractor does not receive payment from the contractor until such time as the owner pays the contractor. Under this scenario, the subcontractor could conceivably properly perform all of its work yet not be paid because of a dispute between the owner and the contractor which has absolutely nothing to do with the performance of the subcontractor’s work. Had the subcontractor realized that his obligations to the contractor would be those undertaken by the contractor to the owner in that written agreement, he would have reviewed that agreement and, perhaps, attempted to negotiate more favorable terms with the contractor.

The same inequities fall upon the owner. Typically, the owner has the least amount of knowledge as to construction matters and relies heavily on the contractor to properly perform its work. Consider paragraph 3.7.4 of the A201 General Conditions which provides as follows:

“If the contractor performs work knowing it to be contrary to laws, statutes, ordinances, building codes … the contractor shall assume full responsibility of such work and shall bear the attributable costs.”

The foregoing provision would require the owner to prove that the contractor knowingly performed work contrary to the building code before the owner can recover damages from the contractor for work that violates the building code. If the contractor violates the building code, he should be liable regardless of

whether he knew it violated the code! Accordingly, owners such as condominium associations and others must be careful before using these forms.

The AIA forms have gained such vast popularity that they are often accepted without even a marginal review. In one instance, it is rumored that a contractor with the assistance of a high tech computer and laser printer, generated a replica of a document that looked like the AIA form, yet the provisions had all been changed to provide a one-sided document in favor of the contractor. Fortunately, the party that was presented with the contract actually read it.

The pitfalls associated with construction contracting do not end with the failure to read contract documents but also from the simple failure of one contracting party to learn anything about the other party to a contract. When dealing with a corporation, contact the Secretary of State to ascertain whether the "corporation" actually exists in the State of Florida. From an owner and subcontractor perspective, ascertain the payment history of a contractor. Utilize agencies such as "Builders Notice" which for a small fee will provide you with a listing of any outstanding tax liens, as well as claims of lien filed by subcontractors against certain contractors.

Ask how long has the party been in business? Does the contractor have the resources and ability to acquire a payment and performance bond to insure that it will perform its obligations under the contract, as well as to pay its labor forces and material suppliers.

The following checklist should be reviewed before entering into a contract for construction services.

1. Find out about the background of the owner, contractor and design professional. Check with the Florida Department of Professional Regulation and Contractors Licensing Board.
2. Is the Corporation licensed in Florida? Call the Secretary of State. They will tell you how long they have been incorporated and will disclose the principles of the corporation.
3. What is their payment history? What tax liens have been placed on their property? Call organizations such as Builders Notice.
4. Can the general contractor acquire a payment and performance bond?
5. Read and understand the contract. Make sure you have all attachments and exhibits.
6. If you do not understand all provisions of the contract, do not sign it until you do. Delete all clauses that you do not understand.

Whether you are a contractor, subcontractor, or a lay person such as a condominium association acquiring services rendered by the construction industry, you can best be served by taking obvious steps which are so often ignored, such as reading and understanding your contract. Know who you are dealing with, and make sure the party that you contract with is everything they represent themselves to be. Only you can inspect your expectations.