

C.A.S.H. 29TH ANNUAL CONFERENCE ON SCHOOL FACILITIES

NEW PROGRAMS, NEW PROMISE CALIFORNIA SCHOOL FACILITIES 2008

Wednesday, February 27, 2008
2:30 p.m. - 4:00 p.m.
Sacramento Convention Center
Room # 307

Workshop #34

Tough But Fair Contracts: With Your Builder, With Your Team

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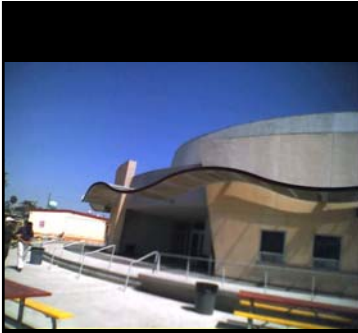
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TOUGH BUT FAIR:

CONTRACTS WITH YOUR TEAM AND YOUR BUILDER

Mark W. Kelley
Bill Savidge
Cate Boskoff

Today's Presentation

- Introduction
- A Tragedy in One (Bad) Act
- Winding back the clock: how to avoid a bad ending
 - Construction Contracts
 - Architect Contracts
 - Subcontractor Issues

The Panel

Mark Kelley, attorney

Miller Brown & Dannis, San Francisco

William Savidge, AIA, engineering officer

West Contra Costa Unified School District,
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CASH Board member

Cate Boskoff, facilities counsel

Oakland Unified School District, Oakland

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Construction Contracts In A Changing Market

Mark Kelley
Miller Brown Dannis

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“We have to start being fair, or our only bidder will stop bidding on our projects!”

Today's Market

- It's still a seller's market for public construction
 - Will remain that way for some time
 - Huge infrastructure \$ chasing too few public Contractors

Today's Market

- You need bidders for your projects
- What drives away bidders?
 - Punitive clauses in front end documents
 - Cumbersome processes
 - Slow payment

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A Scenario: Time to Update

- District is perceived as hostile to contractors
 - Documents seen as one-sided
- Perception that the District is not able to meet its contractual obligations

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A Scenario: Time to Update

- Staff difficulty in managing process-intensive documents and requirements
- But: District is worried about exposure to risk from contractors if contract protections are too weak
 - Pressure to be tough

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Things To Focus On

- You want the District to be the “Owner of choice” for bidding
- Fairness is not weakness
- But:
 - There are some District protections that should not be considered negotiable
 - Even your team members have businesses to take care of – i.e., competing interests to yours

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Foundational Questions

- Create new documents from the ground up, or revise what you have been using?
- Who will take the lead internally?
- Who else gets to have input?

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Foundational Questions

- Process:
 - Written drafts and comments only, or interactive planning sessions?
 - Different documents for different size projects?
 - What parts of the documents can be modified?
 - What CSI format?

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Other Stakeholders

- Who else has a say in the process?
- Examples:
 - Risk management
 - Labor enforcement
 - Project managers
 - Outside consultants (e.g. architects, cm's)
 - Green building, outreach etc.
 - What about the contracting community?

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Key Contract Provisions

- Submittals
- Scheduling
- Payment
- Change Orders
- Liquidated Damages
- Insurance
- Claims Procedures

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Submittals

Issue: Amount of time to allow for submittals on design issues

Common problems:

Delayed submittals + delayed approval
= **delay**

Timing of submittals

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Submittals

Recommendations:

- *Require early submittals*
- *Have a Submittal Contract Milestone date (with LD's attached)*
- *Require prompt analysis and recommendations by design professionals*

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Scheduling Requirements

Issue: When and how much to require (and expect) from the contractor?

Common problems:

No accepted baseline schedule during a project

No schedule updates

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Scheduling Requirements

Recommendations:

- *Tie initial accepted baseline to first/second progress payment*
- *Make acceptable updates part of pay app submittals*

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Scheduling Requirements

Project Reality Check:

What do you do if the work is being completed on schedule, but you don't have baseline or updates?

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Scheduling Requirements

Answer:

- A. Shut up and keep paying, count your blessings!
- B. Stop paying the Contractor until he submits the required schedules.
- C. Call your attorney.
- D. Retire, great job!

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Payment

Issue: Time!

Common problems:

Too many layers of approval

Developing a reputation for slow payment

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Payment

Recommendations:

- *Contractors live by cash flow – get a reputation for prompt payment*
- *Streamline approval process internally*
- *Set timelines for consultant approval of pay apps*

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Change Orders

Issue: Process for approval and payment

Common problems:

Turnaround time delays payment

Lack of closure on time granted means door is open for later delay/impact claim

Change Orders

Recommendations:

- *Set up prompt review and payment process*
- *As much as possible, close the door on later claims with form language of accord and satisfaction*

Change Orders

Project Reality Check:

Contractor won't sign the Change Order without a reservation of rights.

- Most common scenario with experienced Contractors

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Change Orders

- District may have little choice but to sign
 - Even if full accord language included in documents
- Scope of change impacts decision about whether to reach full accord at time of change

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Liquidated Damages

Issue: How much to charge?

Common problems:

Too high: discourage bidders

Too low: won't cover actual Owner costs of delay

Way too low: no incentive to complete on time

Liquidated Damages

Recommendations:

- *Try to calculate what actual costs would be – including staff time, consultant time etc.*
- *Stack LDs if appropriate to phased completion*

Insurance

Issues: Coverages, Limits

Common problems:

Paying for unneeded coverage

Setting commercially unreasonable limits

Insurance

Recommendations:

- *Coordinate with Risk Management*
- *Acknowledge that coverages are rarely adequate (especially for consultants)*

Claims Process

Issues: Unclear or overlapping processes for submitting claims

Common problems:

Expecting waiver language ("Any claim not submitted and documented within 10 days is waived") to be an effective bar

Too complicated a process for staff to administer

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Claims Process

Recommendations:

- *Streamline the process*
- *Encourage documentation*
- *Enforce waivers via change order issued to resolve*

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Bidder Questionnaires

Issue: To what use can they be put?

Common problems:

Turns up negative information on a bidder, but unless the Owner wants to pursue non-responsiveness it has no effect

May discourage bidders to no good end

Bidder Questionnaires

Recommendations:

- *Only use to get fair warning, and only if it won't turn away bidders*
- *Generally, either do prequalification or skip this step*

Escrow Bid Documents

Term: successful bidder must place original bid backup into envelope, held in escrow

- Envelope only opened in event of a claim
- And only with both parties present

Advantage: provides the contractor's real planned cost allocations and methodology, to verify/defend against claim

Escrow Bid Documents

Recommendation:

Include Escrow Bid document requirements for all large projects

Coordination with Architect/Consultant Agreements

Issue: Disconnect between front ends and District's agreements with consultants

Common problems:

RFI turnaround times

Payment review/approval delay

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Coordination with Architect/Consultant Agreements

Recommendations:

- *Make sure that relevant consultant agreements mesh with your obligations to contractors*
- *Focus on their duties up front rather than on their liability to you on the back end*

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Conclusion

- Your contract documents need to be living documents that suit your projects
- Take advantage of the expertise of staff and consultants re what works and what doesn't
- Understand the market, which will strongly affect the protections you can expect in agreements with contractors and consultants

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The Architect's Contract for Public School Construction

A District Perspective

William Savidge, AIA
West Contra Costa Unified School District

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The Architect's Contract

- Contract basics...
 - Fixed fees—defining scope not cost.
- Indemnification
 - Something we can all disagree on!
- Professional Insurance
 - Policy limits, defense costs and the wasting pot of \$.
- The Standard of Care
 - Stopping Budget Busters
- Construction Reality
 - Terms to manage risk
- The job from hell...
 - Claims against the Architect—in for the long haul!
- Contract management leadership
 - Coordinating all construction related contracts
 - Understanding Architects and the role of the District

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Architect Contract Basics

- Don't use AIA or off the shelf forms of contract for District Architectural services
 - School construction requirements are unique
- Have your construction attorney provide the District's form of contract
 - Legal review of each contract
 - Specific terms/language dealt with during contract negotiations
 - Use your attorney wisely!
 - Business terms negotiated by District

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Architect Contract Basics

- Reference contract requirements in your RFQ
 - Shouldn't be surprise about conditions
 - ❖ Indemnification requirements
- Clear definition of the scope of work
 - Project definition, program requirements
 - Increments or phasing needs
 - Budget
 - Schedule
 - ❖ Design schedule
 - ❖ Anticipated Construction schedule

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Architect Contract Basics

- Use fixed fee contracts—based on clear scope!
 - No automatic fee increases tied to cost of construction
 - Learn to love the “ASA”—Additional Services Application
 - Add Services for increased/changed scope

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Architect Contract Basics

- Not for added cost of the construction work
 - ❖ Avoid perverse incentive of paying the Architect extra fee on Construction Change Orders...
- Somewhat more challenging to manage
- Usually save \$--especially in inflationary market

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Architect Contract Basics

- However you define the design team's fee...
- Make sure that you are adequately compensating the team (!)
 - Lack of fee impacts document quality & response time—in design/construction
 - Paying too little can be worse than paying too much

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Architect Contract Basics

- Ensure that project fees by phase are appropriate
 - No front-loading of design team fees
 - Ensure adequate fee left for Construction phase

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Contract Basics: Indemnification

- More concerns on this than any other clause
 - Districts should not consider mutual indemnification
 - "This language is uninsurable." First words in the negotiations

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Contract Basics: Indemnification

- Provides a District with basic protections in the event of professional negligence

- Insist upon strong provisions
 - Meeting requirements of new indemnification limitations

Contract Basics: Indemnification

Article 9. Indemnity / Architect Liability

- 10.1. To the furthest extent permitted by California law, Architect shall defend, indemnify, and hold free and harmless the District, its agents, representatives, officers, consultants, employees, trustees, and volunteers ("the indemnified parties") from any and all claims, demands, causes of action, costs, expenses, liability, loss, damage or injury of any kind, in law or equity, to property or persons, including personal injury and/or death, to the extent that any of the above are caused in whole or in part by the recklessness, willful misconduct or negligent acts, errors, or omissions of Architect, its officials, officers, employees, subcontractors, consultants, or agents directly or indirectly arising out of, connected with, or resulting from the performance of the Services, the Project, or this Agreement except to the extent caused by District's or any third party's negligence ("Claim").

- 10.2. To the extent covered by the above, Architect shall pay and satisfy any judgment, award or decree that may be rendered against the indemnified parties in any such Claim. Architect shall also reimburse District for the cost of any settlement paid by District arising out of any such Claim. Architect shall reimburse the indemnified parties for reasonable legal expenses and costs, including expert witness fees and consultant fees, incurred by each of them in connection therewith or in enforcing the indemnity herein. Architect's obligation to indemnify shall not be restricted to insurance proceeds, if any, received by the indemnified parties. District shall have the reasonable discretion to accept or reject any legal representation that the Architect proposes to defend the indemnified parties.

Contract Basics: Professional Insurance

- Setting Professional Liability Limits
 - Appropriate levels for project size/cost
 - Deductibles
- Insurance limits issues in the claims context

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Contract Basics: Professional Insurance

- Defense costs
 - Protracted legal proceedings may “waste” the policy limits
 - Your attorney should be able to advise District about costs and benefits of pursuing a claim
 - ❖ Develop recovery estimates and scenarios

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The Standard of Care

- Nobody's perfect...
- The Architect is the District's agent in meeting a duty of care to Contractor to provide a biddable, buildable set of documents

The Standard of Care

- Standard of care is defined in relationship to professionals providing similar services
- DSA requirements as the Professional in Responsible Charge

The Standard of Care

- Architect has a critical fiduciary responsibility to the District—meet the project budget!+
- Use contract terms to clearly define responsibility and actions required

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The Standard of Care

- The Redesign Clause
 - Conformance to budget at each phase of design
 - Estimate reconciliation requirement
 - Redesign at bid if over certain threshold
 - Consider issues of timing in inflationary market
- District's budget must be realistic! (the Fair part)

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Construction Administration

- Key elements of the Architect's responsibility
 - Project construction in accordance with plans and specifications
 - Submittals
 - ❖ Substitutions
 - The RFI Process

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Construction Administration

- Approval of completed work
 - ❖ Contractor payment applications
- DSA approval, final certification
- Closeout
 - ❖ The Punchlist

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Construction Administration

- Set appropriate Contract requirements for Construction Phase services
 - Response or review times for design team
 - ❖ RFI's, Submittals, approvals, change order reviews
 - Must be realistic—remember DSA review may be required

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Construction Administration

- Must be coordinated with other project team documents
 - ❖ RFI response times in Architect contract
 - ❖ Construction specifications requirements for Contractor
 - ❖ The CM's responsibility, timing requirements

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Construction Administration

- RFI's—"Ticking time bomb or sincere question about how to build the project"
 - Biggest risk for Districts is delay
 - Failure of the Architect team to respond in a timely manner
 - Set limits within the contract

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Construction Administration

- Project team leadership is important in managing expectations
- Danger signs
 - Excessive numbers of RFI's
 - Responses that don't answer the question

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Construction Administration

- Set appropriate Contract requirements for Construction Phase services
 - Require Architects to provide a “conformed set” prior to start of construction
 - ❖ Make this a part of Basic Services
 - ❖ Provides a clear set of documents with Addenda incorporated into the construction set

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Construction Administration

- Consider full-time presence on jobsite for larger, more complex projects
 - ❖ Better flow of information, project team coordination
- Establish construction site visit requirements
 - ❖ Subconsultants—Mechanical, Electrical, Structural

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Construction Administration

- Changes to the Contract for Construction
 - Unforeseen conditions
 - Owner adds, scope increases
 - DSA additional requirements
 - Contractor-initiated changes
 - Document changes & clarifications
 - ❖ Coordination of plans, specs, disciplines
 - ❖ Errors and omissions in the plans and specs

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Construction Administration

- Managing change in project setting
- Expect to pay the Architect for changes to the project—when appropriate!
- Anticipate that there will be changes due to the documents
 - Strong contract terms establish limits
 - Fair administration ensures parties take responsibility
 - Understand District staff, Board, public limits

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Claims against the Architect

- Some projects will go over the line...
- Clearly define responsibility of the Architect for Construction Change Orders
 - Contract language important – even if often not enforced to fullest!
 - Even if design documents cause Change Order many different levels of responsibility

1. If and to the extent required by California law, Architect shall be responsible for the cost of construction change orders caused directly by the Architect's willful misconduct or negligent acts, errors or omissions. Without limiting Architect's liability for indirect cost impacts, the direct costs for which the Architect shall be liable shall equal the difference between the cost of the change order and the reasonable cost of the work had that work been a part of the originally prepared construction documents.

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Claims against the Architect

- Carefully consider any claim action
 - Ramifications during the project
 - Splitting the District & Architect may be a boon to the Contractor

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Claims against the Architect

- Communication, notification of potential concerns
 - “The Contractor has alleged that your failure to respond to Requests for Information in a timely fashion have delayed the project.”
 - Keep the team on notice if needed, but don't give ammunition to the Contractor

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Claims against the Architect

- Be ready for a protracted fight
 - And be ready to settle
- If the documents and subsequent performance of the Architect clearly do not meet the Standard of Care...
 - Your Board and Community deserve strong action by District staff

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Claims against the Architect

- Be realistic about what you will get back from the Architect's team
- Mediation setting effective if you're prepared

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Contract Management (the Fair part)

- Management issues for Districts
 - Maintaining relationships on the project team
 - While having each member accept responsibility for changes in cost and time
- Build relationships with each team member
 - Communication builds trust
 - Can help the District through difficult projects

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Contract Management (the Fair part)

- Understand the importance of tough contract terms
 - And be aware of their limitations...
- Coordination of all contracts on a project is critical
 - Avoid overlapping roles & responsibilities
 - Similar terms, similar times

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Contract Management (the Fair part)

- Understand nuances of role changes with different Project Delivery methods
 - Design team & Contractor Coordination -- Collaboration

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Contract Management (the Fair part)

- Remember the District's role in leading the project team
 - Timely reviews of design/work
 - Quick responses to information and decision requests
 - Clear direction for projects
 - "Single Source" of contact at District
 - Empowerment of the Architect as team (co)leader with the District
 - Adequate fees to complete work
 - Adequate time to complete the documents

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Avoiding And Managing Subcontractor Pass-Through Claims

Cate Boskoff
Facilities Counsel
Oakland Unified School District

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Introduction

- Make sure to have good General Conditions and Front End documents to give the District advantage
- Subcontractor pass-through claims can be managed with proper backup and procedures
- Look at innovative management approaches to typical job problems
- Stop Notices and resulting legal wrangling can be mitigated

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Managing the Problem

- Subcontractor pass-through Claims
 - What are they?
 - What ramifications for Districts
- Successful strategies for limiting District exposure to pass-through claims
 - Claims and dispute resolution clauses
 - Managing the Stop Notice process
 - Litigating Stop Notice actions

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Subcontractor pass-through claims

A "pass-through" claim may be defined as a claim by a party who alleges to have suffered damages (in this case, a subcontractor) against a responsible party with whom he or she has no contract (the District owner), and which are presented through an intervening party who has a contractual relationship with both (i.e., the prime contractor).

Subcontractor pass-through claims

Issue: Pass-through claims ongoing issue on District projects

Common problems:

Claims presented after completion of project.

- Often without forewarning of Stop Notice actions
- GC and subs may be working together

Subcontractor pass-through claims

Recommendations: Develop effective strategies for managing pass-thru claims

- *Develop Contract Document/General Conditions language to fully implement*

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Subcontractor pass-through claims

- Large project Subcontractors
 - Mechanical, electrical most common
 - Civil/earthwork, steel
 - Sophisticated companies
 - Claims development capabilities well developed
- Asserting contract rights
 - Delay
 - Inefficiency
 - Extended overhead, general conditions
 - Claims may include Change Order work demands

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Subcontractor pass-through claims

- May indicate GC and Sub working together
- Example: The Contractor may have negotiated with the sub to “hold-off” on filing a stop notice (and tying up the flow of construction funds) in exchange for an agreement to pass the claim through to the District.

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Subcontractor pass-through claims

- Contractor “plays it both ways” proposing to form a united front with both sides and working the outcome to his/her advantage.

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Strategies for Limiting Exposure

- Districts need options for a flexible response
- Basic contract management techniques
- Revisit documents to ensure tools available are a part of the contract
- Understand the process
- Legal protections are available to help manage

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Claims and dispute resolution clauses

- Resolve disputes with the contractor as close to the events giving rise to the disputes as possible
 - Avoid stale or late claims and the late documenting of claims
- Tie claim presentation deadline to fixed date
 - Final Payment
 - 30 days following NOC
- Ensure dispute resolution clause contains provisions that all subcontractor pass-through claims be timely brought

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Claims and dispute resolution clauses

- Ensure Subcontractors are informed of the Dispute and Claims Resolution Process
 - Disclosure requirements
 - Require Contractor to indemnify the District and its consultants, against all claims caused by the failure to provide the Dispute and Claims Resolution process to its Subcontractors

Claims and dispute resolution clauses

- Include provision that no claim that fails to follow Dispute and Claims Resolution process, including subcontractor pass-through claims, will be considered.

Managing the Stop Notice process

- Stop Notices...harmless, normal assertion of subcontractor payment rights, or...
- Stop Notices...signal of the coming subcontractor pass-through claims
- Districts need to understand the danger signals
 - Be aware of District rights, ability to deflect Stop Notice actions

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Managing the Stop Notice process

Issue: District's interest is usually in getting Stop Notices released

- But with pass-through claims on the horizon, dynamic changes

Common problems:

Districts are presented with General Contractor Stop Notice Release Bonds to free up funds for payment.

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Managing the Stop Notice process

Recommendation:

Develop a practice of not automatically allowing Contractors to post stop notice release bonds.

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Managing the Stop Notice process

- “If the original contractor or subcontractor disputes the correctness or validity or enforceability of any stop notice, **the public entity may, in its discretion,** permit the original contractor to file with the public entity a bond executed by a corporate surety, in an amount equal to 125 percent of the claim stated in the stop notice conditioned for the payment of any sum which the stop notice claimant may recover on the claim together with his costs of suit in the action, if he recovers therein. Upon the filing of such bond with the public entity, the public entity shall not withhold any money or bonds (where bonds are to be issued in payment for the work of improvement) from the original contractor on account of the stop notice.”

The obligation to honor a stop notice release bond is **DISCRETIONARY!**

California Civil Code Section 3196

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Managing the Stop Notice process

- Aggressive management by the District
 - Requires solid documents
- Example: Good idea to alert the contractor somewhere in the construction documents of the District's right to exercise its discretion to avoid the contractor prematurely posting a bond and incurring the premium costs on a bond that the District has decided not to accept.

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Managing the Stop Notice process

- Forces contractor to deal with subcontractors claims before passing the claims on to the District, making the contractor, not the District, analyze the legitimacy of the claim.

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Stop Notice actions

Issue: Districts are caught in the middle
between General and Subcontractors

Common problems:

Stop Notice actions by the
Subcontractors drag the District into a
dispute between GC and subs

- Costly defense issues—find a way out!

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Stop Notice actions

Recommendation:

*Clearly understand options and be ready
to step out of the line of fire—effective
use of the "Interpleader"*

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Stop Notice actions

- Subcontractor lawsuit to foreclose on Stop Notice
- The usual approach
- Answer and defend the action
 - Expensive, time consuming
 - If this option is selected, be sure and retain the 25% withheld under the stop notice for costs of defense

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Stop Notice actions

- Develop all possible options to consider in responding to Stop Notice actions
- Example: **Tender defense of action to Contractor**
- Express indemnity provision in Prime Contract requires Contractor to accept tender
 - Potential for conflict of interest
 - ❖ **particularly if contractor has independent claims**
 - ❖ **or pass-through claims are pending**

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Stop Notice actions

- Develop all possible options to consider in responding to Stop Notice actions
- Example: **Accept Release Bond posted by Contractor**
- Typical Contractor approach, but not always in District's best interest
 - False sense of security for District

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Stop Notice actions

- Dismissal from "stop-notice" action, but continued exposure to pass-through claims brought by Contractor in cross-complaint
- Only accept release bond if Contractor stipulates that no claims from sub will be passed through.

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Stop Notice actions

- Develop all possible options to consider in responding to Stop Notice actions
- Example: **Interplead Stop Notice funds with Court** (C.C.P. § 386)

Stop Notice actions

- District is only a stakeholder defendant in breach of contract action against Contractor
 - Interpleading funds held by District under subcontractor's Stop Notice is proper
 - Interpleader action compels Subcontractor and Contractor to litigate claims among themselves.

Stop Notice actions

- The Interpleader process
- District deposits Stop Notice funds withheld from the Contract with Superior Court
 - Withheld funds—1.25 x amount of Stop Notice
 - Plus reasonable attorney fees

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Stop Notice actions

- Once District deposits the stop notice funds with the court, it is discharged from liability and freed from the obligation of participating in the litigation.

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Stop Notice actions

- The Interpleader process
- Many advantages for the District
 - Joins all claimants in one action and consolidates separate actions (C.C.§ 3214)
 - District is entitled to a reasonable award of attorney fees and costs (C.C.P.§ 386.6.(a))

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Conclusion

- Make sure to have good General Conditions and Front End documents to give the District advantage
- Subcontractor pass-through claims can be managed with proper backup and procedures
- Look at innovative management approaches to typical job problems
- Stop Notices and resulting legal wrangling can be mitigated

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CONTRACTS WITH YOUR TEAM AND YOUR BUILDER

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