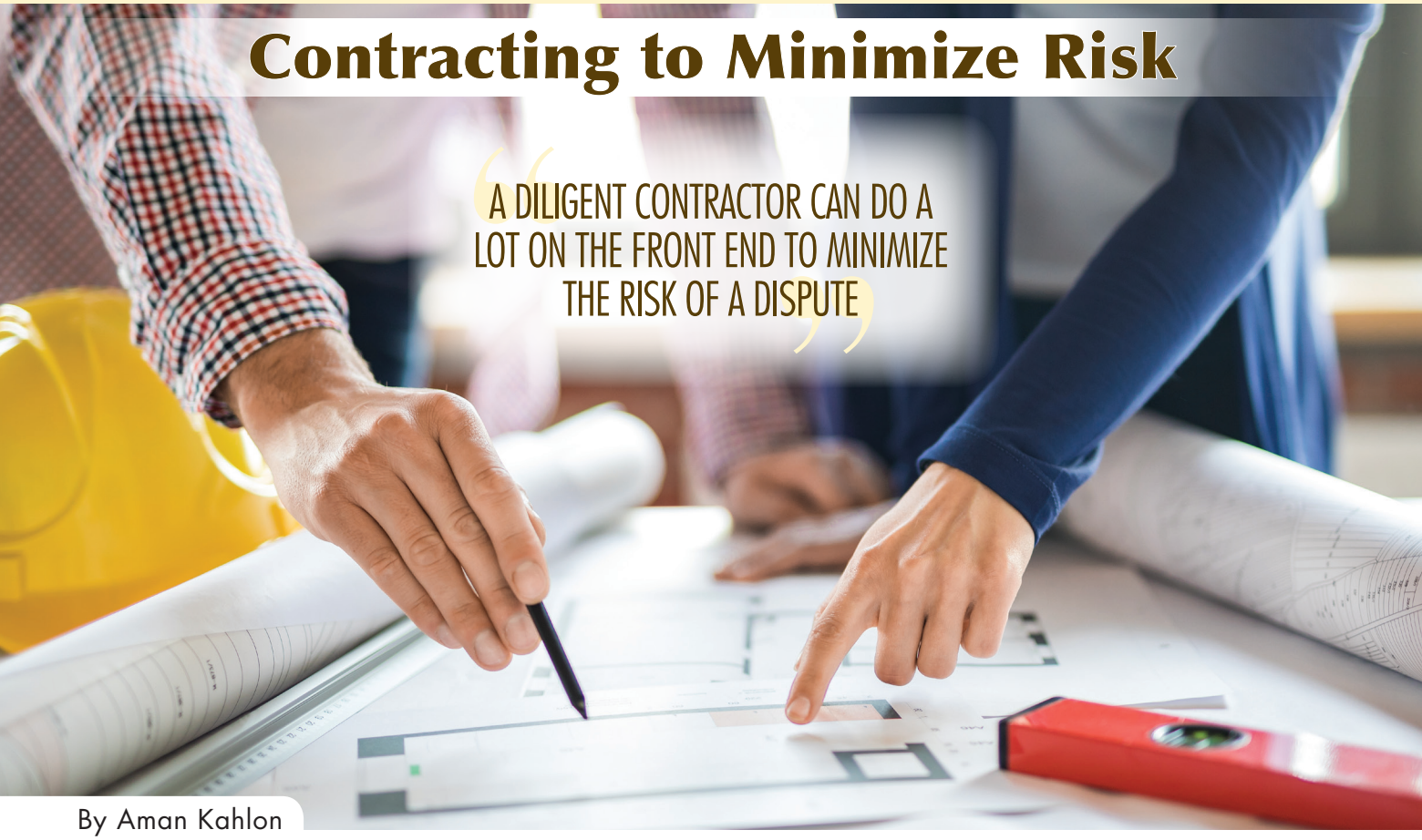
Contracting to Minimize Risk



> "A DILIGENT CONTRACTOR CAN DO A LOT ON THE FRONT END TO MINIMIZE THE RISK OF A DISPUTE"

By Aman Kahlon

Most sophisticated parties want to avoid lawsuits because they understand that such disputes may be detrimental to a project and end up causing everyone involved to incur substantial expenses. While litigation is never a preferred outcome, construction companies may use a dispute as an opportunity to reevaluate internal project administration and contract negotiation processes to help avoid future mishaps. Below I focus on goals that can help guide you through reformation of your company's contracting practices.

Do you have a form/template agreement?

Construction companies do not always get to dictate the contract form they will use in negotiating work. Regardless, having a suite of contract forms that your business typically relies on is invaluable. For one, if a company is negotiating downstream or has other sufficient leverage such that it can dictate the form to be used, that practice can be advantageous. The development of form agreements helps companies identify and allocate risk in a predictable manner making it easier for those entities to manage commercial negotiations and any disputes that may follow.

Even if a contractor can't use its form contract on a particular project, the drafting process helps companies' internal legal and compliance teams refine their understanding of commercial risks and how to manage them. For example, if you have a form contract that outlines change order management procedures and your owner requires you to utilize a contract with a different change order provision, all is not lost. The form change order management procedure will help your legal team identify deviations in the owner-proposed contract and instruct your compliance and project management teams how to adjust their change order administration process on the project in question.

Is your form agreement sufficiently refined?

A key component of creating form agreements is managing them as living documents. In-house legal departments at construction companies are often small, if they exist at all, and, while in-house departments may have form contracts on hand, they do not always have the resources to keep them consistently updated to match changes in the law and their companies. Outdated agreements or agreements drafted under one state's law but used in another state can cause contractors to

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encounter unforeseen risk. For example, lien law requirements vary widely across the nation. Your form agreement may incorporate a lien waiver exhibit that complies with Alabama law but leaves out a mandatory statutory disclosure under Georgia law. Your agreements need to be updated to reflect changes in applicable law.

In addition to potential legal changes, it is important to update your suite of contract templates to keep pace with company growth and entrance into new markets. For example, a brick supply vendor that begins offering masonry services may rely on its previously drafted suite of purchase order forms when negotiating contracts for its masonry services. But, those purchase orders are likely focused on commercial sales risks and not construction contracting risks, so they may not be adequate. Construction companies going through periods of rapid growth should be mindful of these considerations to help avoid disputes.

Have you identified your key areas of concern/risk as a company?

As mentioned above, a lot of companies do not have the resources to develop or update separate contract forms for every potential agreement they encounter. So, what else can you do to help manage contracting risk? You can spend time evaluating your company's key commercial risk concerns and focus your resources and leverage in contract negotiations on these areas. Clients ask outside lawyers to do this all the time: "I've got a project, we're agreed on the pricing, and the owner just sent me a contract for review. I don't want to blow up the deal, but I need to know any significant risks I'm taking on and any particular provisions I should push back on." Sound familiar?

Construction companies should evaluate key risk concerns internally and develop processes to address them in commercial negotiations. For example, Company X knows that limitation on liability caps are important to its risk management. Company Y wants to enter in a $500,000 agreement with Company X for some electrical work on a $50 million project. Company Y wants no limitation of liability.

If Company X says it has to limit its liability to $500,000, Company Y may walk. However, if Company X has already considered this risk internally and developed some alternative approaches, it may be able to offer a compromise position that is palatable for both parties. Company X might, for instance, offer a limitation on liability equal to the aggregate amount of its CGL policy and request a $25,000 premium on the contract price in order to carry the additional risk.

CONCLUSION

There is no one-size-fits-all approach to contract review and negotiation that will avoid litigation altogether. But, a diligent contractor can do a lot on the front end to minimize the risk of a dispute. A keen focus on contract management procedures should pay dividends over time. ■