NBI | NATIONAL BUSINESS INSTITUTE™

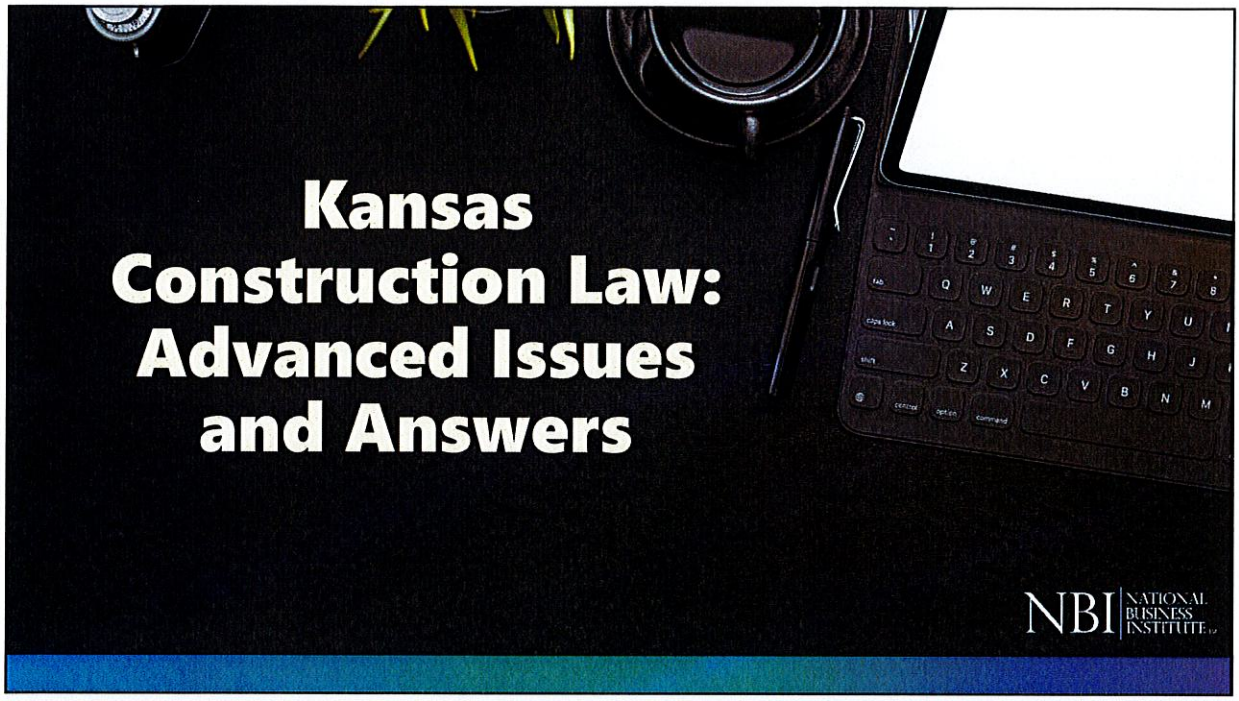
Kansas Construction Law: Advanced Issues and Answers

June 26, 2023 | Product: 96616

nbi-sems.com

Construction Contracts: Advanced Negotiation Techniques for the Top Sticking Points

Submitted by Heather F. Shore



Heather F. Shore, Esq.

2001 Wyandotte Street
Kansas City, MO 64108
Phone: 816-931-0500
www.sls-law.com

SHAFFER
LOMBARDO
SHURIN
ATTORNEYS AT LAW

Heather has over two decades of experience handling complex construction, commercial and surety matters ranging in value from $1,000 to $121 million, on some of the most recognizable projects in the country. Having an undergraduate degree in business with a minor in Economics, Heather brings a unique perspective to these practice areas.

NBI NATIONAL BUSINESS INSTITUTE

A Detailed Overview of the Contract for Construction

Payment Clauses

Timing of Payment:

1. Parties should establish their own deadlines for payment.
2. But be mindful of state and federal statutes governing payment (prompt payment acts in Kansas and Missouri).

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Timing of Payment:

Statutes and Laws to Consider—Public Construction Contracts

- R.S.Mo. § 34.057.1
  - This statute requires the contractor to pay the subcontractor within a specified time of receiving payment from the owner.

- Kan. Stat. Ann. § 16-1903
  - Requires payment by the Owner to Contractor no later than 30 days after the Owner receives a properly completed, undisputed payment application.
  - Requires payment by the Contractor to Subcontractor within 7 business days from receipt of payment from the Owner.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Timing of Payment:

Statutes and Laws to Consider—Private Construction Contracts

- R.S.Mo. § 431.180.1
  - All persons who enter into a contract for private design or construction work shall make all scheduled payments pursuant to the terms of the contract.

- Kan. Stat. Ann. § 16-1803
  - Requires payment by the Owner to Contractor within 30 days from owner's receipt of an undisputed payment application.
  - Requires payment by the Contractor to Subcontractor within 7 business days from Contractor's receipt of payment from the Owner.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Retainage:

- Often the owner retains a percentage from the payments until the end of the project to incentivize the contractor to finish.
- Statutes will limit the amount that can be withheld.
  - Private projects
    - Missouri limits retainage to 10%; declares retainage to be trust funds, and allows retainage to be held for punch list items in an amount sufficient to protect owner.
    - Kansas limits retainage to 10%; requires contractor to pay the subcontractor within 7 business days of receiving payment of retainage.
  - Public projects
    - Missouri caps retainage to 5% of the value of the contract unless the owner determines higher rate is needed; allows owner to hold retainage until completion of punch list items.
    - Kansas limits retainage to 10% and trigger interest if retainage not timely paid.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Common Payment Clauses:

Three types of payment clauses are often seen in construction contracts between General Contractors and Subcontractors:

1. Payment by a Certain Date
2. Pay When Paid
3. Pay-if-Paid

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

1. Payment by a Certain Date:

- In this type of payment clause, the General Contractor must pay the Subcontractor by a specified date (often within 30 calendar days from the date of the Subcontractor's invoices).
- This is most commonly seen on Purchase Orders.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

2. Pay when Paid:

- Under this payment arrangement, the date by which the General Contractor must pay the Subcontractor is calculated in reference to the date by which the Owner *should have* paid the General Contractor.

Example: "Payment is due within thirty (30) calendar days of the date when the General Contractor receives payment by the Owner".

- Note: under this clause, the General Contractor must pay the Subcontractors regardless of whether the General actually does receive payment from the Owner.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

3. Pay if Paid:

- Under this payment arrangement, the General Contractor's payment obligation to the Subcontractor is expressly conditioned on the Owner paying the General Contractor.
- Language must clearly establish a "pay-if-paid" arrangement.
- A "pay if paid" clause is no defense to a mechanic's lien claim in Kansas or Missouri. But Kansas courts have held a surety is not liable to pay subcontractors if the bonded subcontract contains a pay-if-paid clause and the principal has not been paid.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Types of Necessary Documents for Payment:

1. Schedule of values
2. Application for payment
3. Supporting backup documents (*e.g.*, lien waivers, certified payrolls, schedule updates and test results)
   - Some lien waivers may be unenforceable. R.S.Mo. § 429.005.1.

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Interest Accruing on late payments:

- R.S.Mo. § 408.020 = 9% interest rate
- Kan. Stat. Ann. § 16-201 = 10% interest rate

NBI NATIONAL BUSINESS INSTITUTE

Payment Clauses

Terms for Billing Disputed Work:

- These provisions usually state the owner doesn't have to pay for disputed work or she can direct the work through a change directive with the value to be negotiated later.
- Many contracts now require the subcontractor to continue working, even if the parties dispute payment terms.

NBI NATIONAL BUSINESS INSTITUTE

Pass Through and Flow Down Clauses

Incorporation by reference:

- Reference specific, other documents in the contract, and incorporate them into the contract as if fully set forth therein, thus the referenced documents become part of the terms of the contract between the parties.
- The documents do not need to be attached, to be incorporated if the clause is properly drafted.
- Incorporation by reference terms are generally enforceable. *See, e.g., Jim Carlson Construction, Inc. v. Barley,* 769 S.W.2d 480 (Mo. App. 1989) (providing that an arbitration clause is incorporated into a subcontract through incorporation of the contractor's general conditions with the owner).

NBI NATIONAL BUSINESS INSTITUTE

Pass Through and Flow Down Clauses

Flow Down Clauses:

- Flow down clauses typically provide that the subcontractor shall assume to the general contractor certain obligations that the general contractor assumes to the owner regarding the subcontractor's scope of work.
- If there is conflict between the provisions of the general contract and subcontract, courts will generally hold the more specific previsions of the subcontract prevail over the general provisions of the contract or its documents incorporated by reference.

NBI NATIONAL BUSINESS INSTITUTE

Pass Through and Flow Down Clauses

Pass through Clauses:

- These clauses contemplate that claims by subcontractors will be passed through the contractor to the responsible party, such as the owner or another subcontractor.
- On federal projects, only the contractor can pursue claims under the Contract Disputes Act ("CDA"). Therefore, it is common to see liquidating or pass-through clauses in contracts involving federal projects, as a way for a subcontractor to pursue recover of its damages vis-à-vis a pass through provision of the parties' subcontract.

NBI NATIONAL BUSINESS INSTITUTE

No Damage for Delay Clauses

- Address whether the contractor has a right to adjust the contract price after encountering delays at the projects, under various conditions and as a result of one or more potential causes.
- In most states, no damages for delay clauses are enforceable on private projects, so long a they are knowingly made and clearly drafted.
- **MO:** void as against public policy on public projects, except for contracts with the Missouri Department of Transportation (public works projects).
- **KS & CO:** void on public projects – K.S.A. § 16-1907 (KS); C.R.S. § 24-91-103.5(1) (CO).

NBI NATIONAL BUSINESS INSTITUTE

No Damage for Delay Clauses

Example:

"In the event the Contractor is delayed in the prosecution of its work by any act or omission to act of the Owner or its representatives, the Contractor agrees to make no claim for damages for delay in the performance of the Contract, and agrees that any such claim shall be fully compensated by an extension of time to complete performance of the delayed work."

NBI NATIONAL BUSINESS INSTITUTE

No Damage for Delay Clauses

Potential Exclusions:

- Delays caused by active Interference by Owner.
- Delays not within the contemplation of the parties.
- Delays so unreasonable that they constitute abandonment of the Contract.
- Delays resulting from breach of a fundamental obligation of the Owner.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

Scope of Work:

- A well-drafted scope of work clause is one of the most important terms of the contract. Clearly defining excluded work is equally important.

Example:

- *The Subcontractor shall provide all labor, equipment, scaffolding, materials, personnel and tools necessary to complete the scope of work identified in the Specifications attached hereto as Exhibit A and the Plans attached hereto as Exhibit B (Specifications), both of which are fully incorporated herein, relating in any way to electrical work at the Project. The following items are excluded from the contractor's scope of work. . .*

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

Substantial Completion:

- The point in time when the project is fit for occupancy and ready for its intended use. Some courts define this term to mean, "trivial imperfections". Consider the applicable state's law.
- Check the terms of the contract to determine whether this term has been defined.
- Consider the Architect's Certificate of Substantial Completion.
- Remember that Substantial Completion is oftentimes different than Final Completion.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

Other Essential Clauses Performance Clauses:

a. The Contractor's Design Responsibility:

i. Design Review:

- Pay particular attention to design review clauses that may shift the responsibility of reviewing the designs for defects from the owner or architect to the contractor.

ii. Shop Drawing Review:

- Understand the clauses that address the scope of the architect's or engineer's responsibilities in reviewing shop drawings.
- Look for clauses that address the speed at which the shop drawing process must occur.
  - Keep good records of any delays by the design professionals in reviewing your shop drawings.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

b. Waivers and Releases.

- Consider the impact of terms that preclude or waive the recovery for negligence, breach of contract, strict liability, consequential damages, lost profits, etc.
- Review contracts for "acceptance of work" releases which can release all claims upon acceptance of payment or of the work. *Regents of Univ. of Colo. Boulder v. Harbert Constr. Co.,* 51 P.3d 1037 (Colo. Ct. App. 2001) (confirming summary judgment on basis the acceptance of work clause released contractor from all liability for defective work, except warranty obligations).

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

Common Forms of Performance Clauses/Form of Payment Clauses:

1. Lump sum contracts
2. Unit price contracts
3. Time and Materials Contracts
4. Cost plus contracts
5. Cost plus contracts with a guaranteed maximum price

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

1. Lump sum contracts:

- This is a contract for a fixed price.
- The contractor bears all the risk of loss for costs of completion within scope of work defined by the owner.
- Usually competitively bid but less flexibility to negotiate terms when the government sends out the contract for competitive bidding.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

2. Unit Price Contracts:

- This is a contract based on specified unit prices for quantities of work that are estimated.
- Usually involves easily measurable quantities of work.
  - e.g., earth removal, rock removal, concrete placed
- Often done with different prices for different volumes of work anticipated to pass on discounts to owners and lower risk of loss to the contractor.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

3. Time and Materials Contracts:

- The form of contract is often used when the exact time and the scope of the contractor's work is not clearly defined or known.
- The contractor is paid for materials used or consumed in the work, and the labor rates reflecting the time spent to complete its portion of the work.
- Proper documentation is important for these sorts of arrangements.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

4. Cost Plus Contracts:

- Owner pays for the actual cost of the contract plus a flat fee or percentage of the project costs.
- Some courts will impose a "fiduciary relationship" between the owner and contractor that forces the contractor to manage and control costs.
- Limited use because the owner must generally have a large amount of control over the scope of the work and the labor, equipment and supplies to be used.
  - The large management burden placed on the owner has caused a variation of the contract to become used.

NBI NATIONAL BUSINESS INSTITUTE

Performance and Timing Clauses

5. Cost Plus with a Guaranteed Maximum Price Contracts:

- This is a cost plus contract with a clause stating a maximum price that will be paid for the project.
- This clause likely eliminates the need to prove a breach of fiduciary duty for high project costs.
- Note: often there is a "shared savings clause" included wherein the parties split the benefit of projects lower than the maximum guaranteed price to incentivize the contractor to work to keep project costs low.

NBI NATIONAL BUSINESS INSTITUTE

Project Termination Clauses

Termination Clauses:

- Allows for the termination of the contract under an enumerated set of circumstances.

- Types of Termination Clauses:
  - Termination for Convenience:
    - Allows an owner (or contractor) to terminate a contract for any reason (including convenience) or even for no reason.
  - Termination for Cause:
    - Allows an owner (or contractor) to terminate a contract under a specified set of circumstances that usually arise because of the fault of the contractor (or owner, as the case may be).

NBI NATIONAL BUSINESS INSTITUTE

Project Termination Clauses

Example "Termination for Convenience" Clause:

"This Contract may be terminated by the Owner, in its sole discretion, upon 20 days' written notice to the contractor. Upon such notice, Contractor shall immediately stop all work, cancel all orders, and demobilize from the project within 10 days. The contractor is entitled to payment for all work in place, and materials delivered or in route for delivery to the jobsite on the date notice is given."

NBI NATIONAL BUSINESS INSTITUTE

Project Termination Clauses

Example "Termination for Cause" Clause:

"If the Work is stopped for a period of thirty (30) days through no fault of the Contractor or because the Owner has not made payments thereon as provided in the Contract, then the Contractor may without prejudice to any other remedy the Contractor may have, upon 7 days' written notice to the Owner, terminate the Contract and recover from the Owner payment for all work executed and for any loss which Contractor can substantiate through documentation or otherwise resulting from the stoppage of the Work, including reasonable overhead, profit and damages."

NBI NATIONAL BUSINESS INSTITUTE

Liquidated Damages Clauses

- A liquidated damages contract provision imposes payment of a certain fixed amount in the event of a breach of a contract provision.
- **MO:** Liquidated damage provisions are generally enforceable unless they are "so disproportionate to the amount of any such damage reasonably to be contemplated as to be oppressive." Wilt v. Waterfield, 273 S.W.2d 290, 295 (Mo. 1954).
- **KS:** So long as a liquidated damages provision does not constitute a penalty, such a provision is generally enforceable. See, e.g., Kansas Heart Hospital, L.L.C. v. Idbeis, 286 Kan. 183, 184 (2008).

NBI NATIONAL BUSINESS INSTITUTE

Liquidated Damages Clauses

Example:

"The Contractor understands and agrees that the completion of the entire Project within the time provided is an essential feature of this Agreement and that the Owner will sustain substantial damages, the amount of which is not possible to accurately determine at this time, if the work is not so complete. The Contractor, therefore, agrees to proceed with due diligence, taking all precautions and making the necessary arrangements to insure the completion of the work within the prescribed time. The Contractor further agrees that its failure to finally and fully complete the work within the time allowed shall be considered a breach of the Agreement and shall entitle the Owner to collect liquidated damages from the Contractor and/or the Contractor's surety in the amount of $1,000.00 per calendar day for each day the Contractor is late in completing the Project."

NBI NATIONAL BUSINESS INSTITUTE

Heather F. Shore
Shaffer Lombardo Shurin, PC
hshore@sls-law.com / 816-303-9955

II. CONSTRUCTION CONTRACTS:

INTRODUCTION - DRAFTING BASICS.

There is no one-size-fits-all contract that covers the needs of all construction projects, and no standard terms or clauses that are sufficient to address every possible risk or outcome. And while industry standard-form contracts provide a good foundation, parties should avoid using them "as is" and consider modifications that are tailored to the project's specific needs. Likewise, parties should refrain from simply copying and pasting standard language into their own custom contract without understanding how the terms interplay with one another and how the courts might interpret that language.

Accordingly, identifying and understanding key contract terms can minimize unintended results, and having a well-drafted contract which clearly defines the rights and obligations of each party can help to avoid protracted litigation.

SUMMARY OF KEY CONTRACT TERMS AND LANGUAGE.

A contract is, quite simply, an agreement made upon sufficient consideration to either do or refrain from doing, a particular lawful act. Contracts are oftentimes referred to as an agreement, obligation, or legal tie by which a party binds itself expressly or impliedly, to pay a sum of money or to perform or omit to do some certain act or thing. Contracts can be defined as a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.

Both commercial and residential relationships should be memorialized by a written contract that sets forth the duties and responsibilities of the parties to that relationship. When less sophisticated parties are involved, an oral construction contract may also be agreed to; but it is best to avoid oral agreements in construction given the complexities of

the issues. In either case, if one of the parties fails to comply with a term of the contract, the other party has a right to bring a claim for breach of contract.

Contracts can be express or implied. An express contract may be either oral or in writing. An implied contract, on the other hand, may be implied-in-fact, by the words or conduct of the parties; or implied in law. An implied-in-law or quasi-contract is an obligation created by law based on the judge's interpretation of what the parties intended, for the sake of justice and to avoid unjust enrichment. All that is necessary to establish the formation of a valid contract, whether express or implied, are the following: (1) parties competent to enter into a contract, (2) a proper or lawful subject matter, (3) the exchange of consideration (*i.e.,* the price of the bargain and the price paid for a promise), (4) mutuality of agreement or assent on both sides, and (5) mutuality of obligation.

Warranties can also be expressed or implied in a contract. Under Kansas law, like in most states, where a person contracts with another to perform work, and without an express warranty, the law implies an undertaking for the contractor to perform in a workmanlike manner and to exercise reasonable care in doing the work. Wheorigin butent act on the part of the contractor results in a breach of the implied warranty, the breach may be tortious in origin, but can also give rise to an action under the contract. *David v. Hett*, 293 Kan. 679, 697, 270 P.3d 1102 (2011). Colorado requires proof of each of the following to establish the existence of a construction contract: 1) the builder entered into a contract with the plaintiffs for the construction and/or sale of a residential structure; and (2) when the builder gave possession of the residential structure to the plaintiffs, it did not comply with one or more of the warranties implied by law as part of the transaction. CJI-CIV. 4th 30:54 (2018).

In most states, when a homebuilder sells a newly constructed home there are implied warranties of habitability and constructability, regardless of whether the warranties are spelled out in the contract or not. Implicitly, the builder guarantees the house was built in a good and workmanlike manner. *Crawford v. Whittaker Const., Inc.*, 772 S.W.2d 819 (Mo. App. 1989). In Colorado, the courts have likened this implied warranty to "strict liability" for construction defects. *Davis v. Bradley*, 676 P.2d 1242 (Colo. Ct. App. 1983).

A contract is formed at the time the last act necessary to its formation is completed, which is typically the place and time in which the offer is accepted. *See, e.g., Speer v. Sammons Trucking*, 35 Kan. App. 2d 132, 144-45 (2006). These facts are material in determining which state's law may apply in the event of a claim of breach of that contract. If, for example, a contract is made by telephone, then the contract is formed where the acceptor speaks his her or acceptance of its terms. While the existence of a contract is question of fact whether certain or undisputed facts establish a contract is a question of law for the courts to decide. *Webbe v. Keel*, 369 S.W.3d 755, 756 (Mo. App. 2012). Courts will seek to determine the intention of the parties and give effect to it, based on the four corners of the written contract. *Chochorowski v. Home Depot U.S.A.,* 404 S.W.3d 220, 226 (Mo. banc 2013). That is why it is so important that the parties' construction contract is carefully drafted, and that before entering into a construction contract the parties have a fundamental understanding of the key elements needed to reflect their intentions.

A. PAYMENT CLAUSES:

The payment process is one of the most heavily negotiated terms of a construction contract and understandably can cause concern to everyone involved. Owners, as well as lenders, are concerned about overpaying their contractors before the work is completed and commonly hold sufficient retainage as security. On the other side, contractors and subcontractors are concerned about the owner's ability to fund the project, the timing and amount of payment, and their own ability to fund lower-tier subcontractors and suppliers. Any delays in the cash flow can essentially force a contractor to finance the project, which may ultimately result in its insolvency or surety bond claims. The importance of knowing how the payment process works, and negotiating payment clauses, cannot be understated.

1. Timing of Payment:

If possible, the parties should establish their own deadlines for the payment process. The American Institute of Architects and other form construction documents generally set forth suggested payment procedures, but they can still need redrafting and tailoring to the needs of the parties.

When considering payment, parties must be mindful of the laws governing the timing of payment and shifting of the risk of non-payment, for both public and private contracts. Most states, including Kansas and Missouri, maintain a statutory framework for certain construction projects to promote prompt payment through the various construction tiers. These statutes typically include severe consequences for an entity's failure to timely make payment for undisputed work, including interest that accrues at steep rates and recovery of attorney's fees to the prevailing party in an action to recover unpaid invoices. The Kansas and Missouri Prompt Payment Acts are briefly summarized in the table below:

PROMPT PAYMENT ACTS FOR CONSTRUCTION CONTRACTS					
State	**Statutory Authority**	**Payment: Owner to Prime Contractor**	**Payment: Prime Contractor to Subcontractor**	**Payment: Subcontractor to Lower-Tiers**	**Interest and Penalties**
Kansas (Public): For Most Construction Other than Road Work	K.S.A. 16-1901 to 16-1908	Unless otherwise agreed in writing, within 30 days after receipt of invoice. Can be extended to 45 days under extenuating circumstances.	No provision.	No provision.	18% per year. Also mandates recovery of attorney fees and costs to the prevailing party in an action to enforce the statute.
Kansas (Public): For Construction Not Covered by Chapter 16	K.S.A. 75-6401 to 75-6407	Within 30 days after receipt of invoice.	Within 7 business days after receipt of payment from the owner and upon proper request of the subcontractor.	Within 7 business days after receipt of payment from the owner and upon proper request of the subcontractor.	1.5% per month.
Kansas (Private)	K.S.A. 16-1801 to 16-1807. Does not apply to residential	Within 30 days after receipt of a timely, properly completed, and	Within 7 business days after prime contractor receives	Within 7 business days after subcontractor receives	18% per year. Also mandates recovery of attorney fees and costs to the

PROMPT PAYMENT ACTS FOR CONSTRUCTION CONTRACTS					
State	**Statutory Authority**	**Payment: Owner to Prime Contractor**	**Payment: Prime Contractor to Subcontractor**	**Payment: Subcontractor to Lower-Tiers**	**Interest and Penalties**
	construction of 4 units or less.	undisputed payment request.	payment from owner.	payment from prime contractor.	prevailing party in an action to enforce the statute.
Missouri (Public)	R.S.Mo. § 34.057.	Within 30 days after the later of: (a) date of delivery of material or performance; (b) date of invoice delivery; (c) date contractor approves owner's estimate.	Within 15 days after prime contractor receives payment from owner.	Within 15 days after subcontractor receives payment from prime contractor.	1.5% per month if payment is "not withheld in good faith for reasonable cause." Also permits a prevailing party to recover attorney fees and costs in the court's discretion.
Missouri (Private)	R.S.Mo. § 431.180. Does not apply to residential construction of 4 units or less. *See also* R.S.Mo. § 436.300.	Payment shall be made pursuant to the terms of the contract.	Payment shall be made pursuant to the terms of the contract.	Payment shall be made pursuant to the terms of the contract.	Up to 1.5% per month at the court's discretion. Also permits a prevailing party to recover attorney fees and costs in the court's discretion.
Colorado (Public)	C.R.S. §§ 24-91-101 to 24-91.103.	At the end of each calendar month, or as soon thereafter as practicable.	7 days after the prime contractor receives payment from the owner.	7 days after the subcontractor receives payment from the contractor	For payments to subcontractors, 15% per year or the amount specified in the contract,

PROMPT PAYMENT ACTS FOR CONSTRUCTION CONTRACTS					
State	**Statutory Authority**	**Payment: Owner to Prime Contractor**	**Payment: Prime Contractor to Subcontractor**	**Payment: Subcontractor to Lower-Tiers**	**Interest and Penalties**
					whichever is higher.
Colorado (Private)	None	None	None	None	None

2. Retainage:

Oftentimes the owner or contractor will withhold a specified percentage of progress payments from the contractor or subcontractor until the end of the project or a specified time, to incentivize the contractor or its subcontractors to finish the work completely and correctly. This also protects the bond surety in the event of a contractor default or termination, or protects the owner if mechanic's liens are filed against the project despite payment to the contractor. Retainage on a project is typically between 5% to 10% of each progress payment, except where governed by specific laws.

Although common, this practice can cause financial burden on contractors or subcontractors because retainage is typically not released until the end of the project; thus, they are essentially financing a portion of the project. Additionally, contractors or subcontractors which completed their work towards the beginning of the project may have to wait several months, or even years, to receive their retainage, without being entitled to interest.

To alleviate those inequities, many states have sought to impose limitations on the amount of retainage on both public and private projects. R.S.Mo. § 436.303 (capping total retainage at 10% on Missouri private projects, allowing for substituted security, mandating line item release of retainage, and allowing for retainage in an amount sufficient to protect the owner to ensure the work is completed but such amounts shall be held by the owner in trust for the benefit of the contractor and contractor's subcontractors, sub-subcontractors, and suppliers at whatever tier who are not in default, in proportion to their respective interests); Missouri Public Works and Prompt Payment Act § 34.057(1) (capping retainage

at 5% of the value of the contract or subcontract unless the public owner and the architect or engineer determine that a higher rate of retainage is required to ensure performance of the contract, but in no case shall retainage exceed 10% percent; granting the owner the authority to reduce retainage below 5%; and allowing retainage of 150% of the value of a punch list item). *See also Epic, Inc. v. Kansas City, Mo.*, 37 S.W.3d 360 (Mo. App. 2001).

The Kansas Fairness in Private Construction Act, K.S.A. § 16-1804, allows an owner and, in turn, a contractor, on a private project to withhold up to 10% of retainage and requires the contractor to pay the subcontractor its retainage within seven business days from the date that the contractor receives retainage from the owner. Punch list work must be paid within 45 days of completion of that work, but within the regular payment cycle.

On Kansas public projects an owner must release the retainage on any undisputed payment due on a construction project within 30 days after substantial completion of the project; however, if any subcontractor is still performing work on the project under its subcontract, an owner may withhold that portion of the retainage attributable to such subcontractor until 30 days after that portion of work is completed. K.S.A. § 16-1904. Failure to pay retainage results in interest accruing at 18% per year.

Some contracts reduce or eliminate retainage as a certain portion of the work is completed. For example, if 50% or more of the work has been completed to the owner's satisfaction, the retainage may be reduced or eliminated completely. Other contracts exempt certain parts of the billing from retainage, such as the construction manager's fee, materials, general conditions, or the general contractor's own labor.

3. Common Payment Clauses:

Contractors routinely include risk-shifting payment clauses in their subcontracts, which are typically met with a lot of resistance during the course of contract negotiations. There are typically three types of payment clauses in construction contracts between a general contractor and a subcontractor: (a) "Payment by a Certain Date"; (b) "Pay When Paid"; and (c) "Pay If Paid".

a) Payment by a Certain Date:

This clause is less common in construction contracts between general contractors and subcontractors. As the name suggests, this clause is generally straightforward and requires the general contractor to pay the subcontractor by a specified date – often within 30 calendar days from the date it receives the subcontractor's payment application.

b) Pay-When-Paid:

A "pay-when-paid" clause, typically confused with a "paid-if-paid" clause, is a timing mechanism for payment to a subcontractor. A pay-when-paid clause allows a reasonable time period for the contractor to pay its subcontractors or suppliers, once it receives payment from the owner. This type of clause provides that the date of payment is calculated in reference to the date by which the owner is expected to pay the general contractor.

Pay-when-paid clauses are generally enforceable on both public and private construction projects in Missouri. *See American Drilling Serv. Co. v. City of Springfield*, 614 S.W.2d 266 (Mo. App. S.D. 1981). Kansas courts also recognize that this type of clause is "a reasonable provision to postpone payment for a reasonable period of time after the work was completed, during which the general contractor would be afforded the opportunity of procuring from the owner the funds necessary to pay the subcontractor." *Shelley Elec., Inc. v. U.S. Fidelity & Guar. Co.*, 1992 WL 319564 (D. Kan. 1992).

A "pay-when-paid" only delays payment by a contractor for a reasonable time period; these clauses do not allow the contractor to avoid payment altogether. Ultimately, the contractor is legally responsible for paying its subcontractors or suppliers, even if the contractor does not receive payment from the owner. Specifically, in *American Drilling Service Co. v. City of Springfield*, 614 S.W.2d 266, 273 (Mo. App. S.D. 1981), the court ruled that a pay when paid clause "merely fixes the time when payment is due and does not establish a condition precedent to payment." The court held, "[these clauses] only postpone payment by the general contractor for a reasonable time after completion of the subcontractor's work." *Id.*

c) Pay-If-Paid:

If effectively drafted, a "pay-if-paid" clause will allow a contractor to avoid paying its subcontractors and suppliers if it is not first paid by the owner. These clauses are generally construed as fee-shifting, because the contractor's obligation to pay the subcontractor is contingent upon the owner having paid the contractor. Courts in most jurisdictions disfavor "pay-if-paid" clauses and will not find that a pay-if-paid clause exists unless the clause is drafted with concise and explicit "condition precedent language" clearly showing the parties' intent to shift the risk of the owner's non-payment from the contractor to the subcontractor. *A. Zahner Co. v. McGowan Builders, Inc.*, 497 S.W.3d 779, 784 (Mo. App. 2016).

Most courts hold that, if a payment provision is not clear and expressive in its intent to shift the risk of the owner's non-payment onto the subcontractor, then it will be enforceable only as a "paid when paid" clause. *Main Elec., Ltd. v. Printz Servs. Co.*, 980 P.2d 522, 526 (Colo. 1999); *Meco Systems, Inc. v. Dancing Bear Entertainment, Inc.*, 42 S.W.3d 794, 806 (Mo. App. S.D. 2001). The burden of providing a clear expression of the intent of the fee-shifting "paid if paid" term is on the party which drafted the payment provision. *Meco Systems, Inc.*, 42 S.W.3d at 806.

Courts have long been split over the determination of whether a surety may rely on its principal's "pay-if-paid" clause to avoid downstream liability. *See, e.g., Moore Bros. Co. v. Brown & Root, Inc.*, 207 F.3d 717 (4th Cir. 2000) (holding that the surety could not rely on the subcontract's pay-if-paid clauses as a defense to the subcontractor's payment bond claims); *cf. Wellington Power Corp. v. CNA Surety Corp.*, 217 W. Va. 33, 614 S.E.2d 680 (2005) (holding that a pay-if-paid subcontract clause did not violate West Virginia's public bond statute, thus a pay-if-paid clause that prevents a subcontractor from proceeding against the contractor in the absence of the project owner's payment likewise prevents the subcontractor from proceeding against the contractor's payment bond).

The Kansas bankruptcy court has held that a surety may rely on a valid pay-if-paid clause to avoid paying bond claimants, if its bond principal has not been paid those amounts. The court based its analysis on the fact that a surety's liability is co-extensive

with that of its principal's liability; and thus, if the principal is not liable based on the paid-if-paid defense, then neither is the surety. *Faith Techs., Inc. v. Fid. & Deposit Co. of Md.*, 2011 U.S. Dist. LEXIS 7688 (D. Kan. Jan. 26, 2011). However, a conditional payment clause is not a defense to a federal Miller Act payment bond claim in most cases. These courts have concluded that a surety's liability is not co-extensive with the principal's liability to the contractor. *See, e.g., Use and Benefit of Walton Tech., Inc. v. Weststar Eng., Inc.* 290 F.3d 1199 (9th Cir. 2002) ("paid when and if paid" clause not a defense to a Miller Act bond claim).

The AIA documents apply a middle ground in attempting to assist the parties with avoiding any dispute regarding fee-shifting clauses, while also protecting the owner's interest. The AIA payment clauses provide that the contractor promptly pay each subcontractor upon receipt of payment from the owner out of the amount that was paid to the contractor on account of that subcontractor's work. The clause is deliberately vague and states only what the prime contractor should do if it is paid.

Statues in many states, including Kansas and Missouri, prohibit fee-shifting and timing terms as a means of avoiding a lien filing, based on principles of public policy. R.S.Mo. § 431.183 (contingent payment clauses do not prohibit the filing of a mechanic's lien); K.S.A. § 16-1903 (same). Furthermore, the Kansas Fairness in Private Construction Act, K.S.A. § 16-1802 *et seq.*, prohibits the waiver of a right to litigate mechanic's lien rights and subrogation rights, except in cases where there is wrap-up insurance, and states that a pay-when-paid clause is not a defense to a bond claim or a mechanic's lien. The Kansas Act also allows the suspension of work if a contractor is not timely paid and goes so far as to allow contractors a time extension and demobilization and remobilization costs for resulting delays. These Acts exclude residential construction and public works projects. *See* K.S.A. 75-6401; *D-1 Constr., Ltd. v. Unified School District No. 229*, 14 Kan. App. 2d 245 (1990).

4. The Types of Documents Necessary for Payment:

Nearly all construction contracts specifically set out specific requirements for billing and collecting progress and final payments. Under the AIA family of contracts, the

contractor initiates the process by submitting a standard form Application for Payment to the Architect on a specific day every month. The Application is required to be itemized, notarized, and supported by substantiating backup documentation and data reflecting the progress of the work. The owner or its lender may require additional documentation as a condition to payment, such as lien waivers, certified payrolls, schedule updates and test results.

Lien waivers should be carefully scrutinized in light of the lien laws of the state in which the project is located, before execution. K.S.A. § 60-1101, *et seq*. and R.S.Mo. § 429.010, *et seq*. Many states also prohibit an owner or contractor from forcing the subcontractor to waive or release its lien rights upon its receipt of payment of sums due. *See, e.g.,* R.S.Mo. § 429.005 (a contract clause waiving a mechanic's lien right is against public policy in Missouri and, therefore, unenforceable). Some lenders attempt to require the contractor to sign a subordination agreement prior to commencing construction, in an effort to place itself in a priority position in the event of a dispute over non-payment resulting in the filing of mechanic's liens. These should be carefully reviewed and scrutinized.

Before the contractor submits the first payment application, the contractor must submit a Schedule of Values subject to the architect's approval. This schedule allocates portions of the contract price to designated work functions. The architect then uses this schedule to scrutinize the applications as a check and balance system to avoid front-loading by the contractor (increased values placed on work at the beginning of the job) and advancement of payment prior to work being accomplished.

5. Interest Accruing on Late Payments:

The AIA documents provide an option to determine interest rates to be applied for late payments. A fair method is to use the interest rate that the owner is being charged on the construction loan for the project. By doing so, the owner would be discouraged from using the contractor as a financing source. In the absence of an interest provision, a default rate is provided by statute in both Kansas (at 10%, pursuant to K.S.A. 16-201) and Missouri

(at 9%, pursuant to R.S.Mo. § 408.020). But note the public and private prompt payment acts in both Kansas and Missouri allow for 18% interest, as stated above.

6. Terms for Billing Disputed Work:

Most construction contracts provide that any work disputed by the owner may not be billed. On the other hand, the owner may direct this work to be done through the process of a construction change directive with the amount to be paid for the work to be determined at a later time. The contractor may bill for this work up to the amount agreed to by the owner, which treats both parties fairly.

B. PASS THROUGH AND FLOW DOWN CLAUSES:

Other terms common to commercial construction contracts are the incorporation by reference, pass through, and the flow-through or the flow-down, clauses.

1. Incorporation by reference:

Incorporation by reference clauses state that specific other documents referred to in the contract are incorporated into the contract as if fully set forth therein, thus the referenced documents become part of the terms of the contract between the parties. These clauses are typically intended to incorporate design and construction documents and other exhibits into a construction subcontract, for the purpose of binding the subcontractor to the terms and conditions of the contract between the owner and the upstream contractor with respect to the subcontractor's work. The contractor should prioritize these terms in their subcontracts to ensure that the subcontractor complies with the same obligations and responsibilities that the contractor owes the owner. These clauses generally provide that the liabilities will flow the same way.

Incorporation by reference terms are generally enforceable. *See, e.g., Jim Carlson Construction, Inc. v. Barley,* 769 S.W.2d 480 (Mo. App. 1989) (providing that an arbitration clause is incorporated into a subcontract through incorporation of the contractor's general conditions with the owner). *But see Metro Demolition & Excavating Co. v. HBD Contracting, Inc.,* 37 S.W.3d 843 (Mo. App. 2001) (holding that arbitration cannot be incorporated into a subcontract by reference; but reaching that conclusion apparently because the general contract did not exist at the time when the subcontract was

signed). It is also not necessary that the incorporated documents be attached to the contract being signed but is always good practice to do so. Some courts have gone so far as to suggest that the referenced documents do not need to exist at the time.

Understanding the concept of incorporation by reference clauses is important because the terms of the incorporated document can have a material impact on the parties, particularly on subcontractors. Contractors can be reluctant to provide copies of those documents to the subcontractor. Subcontractors should be keenly aware of this difficulty and insist on seeing any documents to which the contractor intends to bind them.

2. Flow down clauses:

Often there is a dispute between subcontractors and contractors about which clauses, terms, and conditions actually flow-down to the subcontractor. For example, parties may dispute whether only the terms and conditions that may apply to the subcontractor's scope of work flow-down or whether all conditions flow-down including terms and conditions contained in the general and supplementary terms regarding insurance, documentation and notice of claims, bonding, venue, dispute resolution, etc.

3. Pass through clauses:

Pass through clauses are common in contracts involving more complex construction projects and federal projects. These clauses contemplate that claims by subcontractors will be passed through the contractor to the responsible party, such as the owner or another subcontractor. On federal projects, only the contractor can pursue a claim for equitable adjustment or claims under the Contract Disputes Act ("CDA"). Therefore, pass-through claims are a viable mechanism for a subcontractor to pursue recover of its damages vis-à-vis a pass through provision of the parties' subcontract. These clauses typically state that the subcontractor must provide certain supporting documentation to the contractor, and present the claim to the contractor within a certain time period. Also, the subcontractor will be responsible to pay all costs and fees associated with preparing and pursuing the claim if it has been denied, even if the claim must be presented in the name of the contractor (such as under the CDA).

A key practice tip is to include language which ensures that, if the contractor is going to control the subcontractor's claims for damages caused by a third party in privity of contract with the contractor (i.e., the owner or another subcontractor) by way of a pass-through clause, then the contractor has the obligation to timely and properly present the claim to that third party and advocate for the claimant as if it was the contractor's own claim.

C. NO DAMAGE FOR DELAY CLAUSES:

A "no damages for delay" clause protects a party—typically the contractor or owner—from having to pay damages arising out of delays beyond their control. It is important to consider the state's law applicable to your contract in determining whether a "no damages for delay" clause is enforceable, as states have differing opinions on the issue.

Missouri, Kansas, and Colorado courts generally enforce these terms on private construction projects, so long as they are knowingly made and clearly articulated. *See e.g., Roy A. Elam Masonry, Inc. v Fru-Con Construction Corp.,* 922 S.W. 2d 783 (Mo. App. 1996). But in Missouri these terms are void as against public policy on public projects, with the exception of contracts with the Missouri Department of Transportation. R.S.Mo. § 34.058. "No damages for delay" clauses are also unenforceable on public projects in Kansas under K.S.A. § 16-1907 and in Colorado under C.R.S. § 24-91-103.5(1). Many other states also void these terms, on the basis that it is against public policy to deny a party from receiving monetary compensation arising out of delays to a project.

D. PERFORMANCE AND TIMING CLAUSES:

1. Scope of Work:

Clearly identifying the precise scope of work to be performed by a contractor on the project is essential to any commercial or residential construction contract. Scope of work clauses are often overlooked at the contract negotiation stage and is the origin of many disputes in a construction project. A well-drafted scope of work clause sets forth sufficient detail to ensure that the parties have a clear understanding as to exactly what is included in the parties' contract. A clause which clearly defines excluded work is equally important. The following example includes common scope of work language:

> *The Subcontractor shall provide all labor, equipment, scaffolding, materials, personnel and tools necessary to complete the scope of work identified in the Specifications attached hereto as Exhibit A and the Plans attached hereto as Exhibit B, both of which are fully incorporated herein, relating in any way to electrical work at the Project. The following items are excluded from the contractor's scope of work. . .*

From this example, the parties have a clear understanding that the contractor will complete its work in accordance with the details set forth in the Project Plans and the Specifications, and which items would be excluded from that contractor's work.

2. Substantial Completion:

Substantial completion is a key component of determining timing of payment and completion of performance of the work. This provision is material to every construction contract. The construction contract may define substantial completion different than final completion. Without the benefit of such definitions, parties may dispute whether the project is in fact substantially complete. Most courts agree that substantial completion means there is only minor work, "punch list" items, or trivial imperfections remaining in the work, but the project is fit for occupancy and ready for its intended use. Said another way, "substantial completion" is the stage of a contractor's work that is sufficiently complete in accordance with the requirements of the contract. Certain final inspections may be needed before final completion is achieved.

The substantial completion date carries significant legal weight. The substantial completion date can vary at different stages of the project, such as when a temporary or final occupancy certificate is issued, the date which the owner occupies the project, or a date which the design professional certifies the date of substantial completion. Therefore, all parties to a contract must ensure to clearly define the substantial completion date, and appointing a third party such as an Architect to issue a certificate of substantial completion can help to alleviate disputes over its meaning.

3. Other Essential Clauses Performance Clauses:

a) The Contractor's Design Responsibility:

i. Design Review:

Generally, construction projects are designed by architects or engineers and built by the contractor who simply follows the plans and specifications. But given the nature of construction, however, every project involves various details of construction that are not specified in the plans and specifications. Nevertheless, most experienced contractors know how those details should be completed. The situation can be complicated, however, with respect to certain types of work that are routinely designed by contractors or subcontractors specialized in their respective trades, including mechanical, electrical and sprinkler systems, to name just a few.

The contractor is generally responsible for following the plans and specifications and is liable for not conforming to them. However, if the contractor is required to follow the plans and specifications, and can prove that it did so, then typically the contractor will not be held responsible for consequences caused by defects in the plans or specifications. *United States v. Spearin*, 248 U.S. 132, 136 (1918). This general rule is subject to a number of exceptions, however.

Some owners may try to shift this risk back to the contractor by imposing a duty on the contractor to review the plans and specifications and attempt to discover design errors and inconsistencies before starting work. Contractors should resist this shifting process because the design professionals have the appropriate skill level and are charged with the responsibility to prepare such design. It is simply unfair to shift that burden to a contractor who has limited time or skills to review and understand the design during the bidding phase. These types of liability-shifting terms are often found in supplementary conditions or in amendments to the standard form General Conditions, and they must carefully be considered prior to agreeing to the contract.

ii. Shop Drawing Review:

Contractors are typically required to provide shop drawings with respect to how they plan to supply the details of the design that are not specified in the contract documents.

These designs are shown on shop drawings prepared by each subcontractor, and they illustrate how the subcontractor will complete its part of the work. Generally, these documents are submitted to the designer through the general contractor for review and a stamp of approval.

Many disputes arise from the shop drawing process. Architects and engineers attempt to avoid responsibility for the sufficiency of the detail in the shop drawings by reviewing and/or stamping them with a disclaimer which states that they have reviewed the illustration "only for general conformity with the contract documents". Subcontractors and contractors, on the other hand, argue that review and acceptance of their shop drawings gives the drawings the same legal effect as the original contract documents, such that they can be relied on by the contractor. Subcontractors and contractors typically also argue that approved or stamped shop drawings are the fault of the reviewing design professional if they prove to be incorrect or defective. If it is shown that the design professional observed a mockup as part of the submittal process, then the designer may be held liable for damages resulting from defects in construction that could have been prevented by the exercise of ordinary skill and attention of a person in the designer's same profession.

Disputes also arise from the speed of the shop drawing process. Time is important and costly on a project, and the parties must be attentive to the length of the process of shop drawing submittal, review, and return. This process may severely impact the contractor's ability to meet the owner's schedule provided in the contract documents. Retaining accurate and complete documentation is very important in those instances where the contractor or subcontractor is waiting on a submittal review that is delaying its work at the project.

4. Common Forms of Construction Contracts, by Payment Method:

a) Lump Sum Contracts:

Lump sum, or stipulated sum, contracts are the traditional and most common type of contract used in the construction industry. The owner and contractor agree on a fixed price for the completion of the contractor's work. Under a lump sum arrangement, the contractor bears all risk of loss with respect to the actual costs of completing the work within the scope defined by the owner's construction documents. Typically, lump sum

contracts are competitively bid and are commonly used for public works projects which ultimately provide less flexibility in the negotiation stage.

b) Unit Price Contracts:

A unit price contract is based on specified unit prices for estimated quantities of work. Unit price contracts are typically used on construction projects where the scope of the work to be performed is known by the parties, yet the precise quantities needed to complete the work are not known or easily determined at the time. The owner pays for the actual units or quantities that are constructed or supplied by the contractor, based on an agreed-upon price per unit or quantity. Unit price contracts are common on public works projects such as highway, dam, and bridge building projects, and is a preferable method of determining payment on projects involving earth removal, rock removal, concrete placement, etc., because precise amounts are not known until the work is completed.

c) Time and Materials Contracts:

A time and materials, or "T&M", contract is often used when the exact time and the scope of the contractor's work is not clearly defined or known. A T&M contract pays the contractor for the materials it used, as well as the amount of time spent to complete its portion of the work. These contracts frequently include a contractor's or subcontractor's standard rate sheet, including hourly labor, overhead costs, general expenses, and material markups.

d) Cost-Plus Contracts:

Cost-plus contracts are popular with private owners. In a cost-plus contract, the owner pays for the actual cost of the project plus either a flat fee or a percentage of the project costs. The contractor is required to substantiate its costs to perform the work in order to be paid. An advantage of a cost-plus contract is that the owner only pays for the work that the contractor performs. A potential disadvantage of a cost-plus contract, at least for owners, is that a contractor has little incentive to keep the construction costs down. There is a small body of law with respect to cost-plus contracts, however, in which courts impose upon the contractor a "fiduciary relationship" with respect to the owner, that compels the contractor to manage and control the costs. This contract method is generally

favored where an owner retains a large degree of control over the scope of the work and the labor, material, equipment and supplies to be furnished, which places more of a management burden on the owner. As a result, another variation of this contract type has emerged, which is the cost-plus with a guaranteed maximum price.

e) Cost-Plus Contracts with a Guaranteed Maximum Price:

The cost-plus with a guaranteed maximum price contract, sometimes referred to as a "GMax", is just like a cost-plus contract, but with a guaranteed maximum price for the construction. The advantage here is that there are limitations on what "costs" a contractor can charge to the project and a cap placed on the amount the contractor may charge. The contractor is simply responsible for the costs which exceed the guaranteed maximum price. These contracts frequently include shared savings clauses in which the parties split any cost savings when the cost of the work is less than the guaranteed maximum price, incentivizing the contractor to minimize the actual cost of the work. This method is very popular with private developers where projects are on a fast track, as they often want to commence construction before a complete design is finalized, and a lump sum price is established.

f) Allocating Risk Within Your Contract:

The exposure to risk exists in every single construction project, no matter its size or complexity. Risk is the natural byproduct of uncertainty: Are there any unknown site conditions? What happens if the project gets delayed by another party, or if the project experiences property damages, personal injuries, or work stoppages? Who would be responsible if a party was given defective plans or specifications? Can one party shift its risk to another party and, if so, how and to what extent? These questions, among many concerns inherent to a construction project, are why properly allocating and managing that risk is central to the negotiation process.

Coming to a final agreement can often be an arduous task, as each party to the contract will seek to minimize their risk and maximize the reward. Owners, contractors, and subcontractors also carry their own inherent risks on a project and will frequently attempt to shift some or all of the risk to the other party to the fullest extent possible. On

the other hand, the parties are also trying to balance their business interests against the known risk, while maintaining business relationships with one another. There are many ways to re-allocate risk, including through insurance provisions, indemnification clauses, requiring that certain aspects of the work be design-build, payment risk-shifting provisions, and the like.

E. PROJECT TERMINATION CLAUSES:

1. Termination for Convenience:

Termination for Convenience clauses allow the owner to cancel a project after the construction contract has been executed, for *any* reason. This usually only happens when something very dramatic occurs on the project; for instance, if the owner loses all of its financing, the owner is having financial problems, or if permits to do the work are not issued or are withdrawn.

These clauses generally require the owner to pay the contractor its actual costs up to the point of notice of termination for convenience. The contractor may also receive demobilization costs. If any overhead costs have not been recovered through billings for the work performed to date, the contractor may seek those costs as well. Occasionally contractors may seek lost profits on the unperformed portion of the work, although owners generally resist agreeing to any obligation to pay lost profits for work not performed.

2. Termination for Cause by the Owner:

Termination for Cause by the Owner clauses entitle the owner to terminate the contract if the contractor persistently fails or refuses to supply properly skilled workers and materials, fails to pay its bills to subcontractors and suppliers, persistently disregards applicable laws, ordinances, or rules, or is otherwise guilty of a "catch-all" substantial breach of the contract, which might include failure to provide insurance, bonding, or other technical requirements. Though termination may be the last thing an owner considers during the contract negotiation phase, owners should make sure to provide clear circumstances giving rise to a termination for cause.

Some contracts require that the architect (or the design professional appointed to fill that role for the project) certify that such cause exists, and then owner may, without

prejudice to other rights and remedies, terminate the contractor after providing further written notice (typically seven days). These terms are often negotiated to provide multiple notices or to extend the notice time and to give rights to cure. If the cost to complete the work exceeds the unpaid balance of the contract sum, which is almost always the case, the contractor is responsible for the amounts over and above the contract sum. It is helpful to add a provision that the surety, by issuance of its bond, agrees to likewise be held responsible.

3. Termination for Cause by the Contractor:

Contractors invest a lot of time and resources on a project and seldom wish to terminate their contracts. However, some unpredictable situations may appear during the course of the project that are so unbearable that a contractor decides to take that drastic action and exercise their termination rights for cause. Contractors most frequently terminate the contract when the owner fails to make payment for thirty days, or if the architect fails to recommend payment for thirty days, through no fault of the contractor.

Before terminating for cause, contractors should consider the dispute resolution procedures existing in the contract, to the extent practicable. Experience and case law dictates that any time a contractor leaves a project prior to its completion, no matter what the reasons, that contractor's actions are usually taken at their own peril and will be looked on unfavorably except under the most extreme circumstances.

F. LIQUIDATED DAMAGES CLAUSES:

Most in the construction industry are familiar with the phrase "time is of the essence" and know that time is equivalent to money in construction. An owner can suffer significant losses when a project is delivered late, and major disputes can result with respect to the owner's losses for late delivery. To address these issues, owners frequently desire to assess liquidated damages (commonly referred to as "LDs") against the parties responsible for delaying the project's completion. These clauses almost always work by assigning a daily charge for substantial completion of the work later than the approved completion date. Often, in public contracts, the daily charge will go beyond substantial completion to final completion.

1. Elements:

Liquidated damages should be some combination of lost profits from late completion and administrative expenses from continued oversight of the project, coupled with the cost of disruption to move into the project.

Calculating this damage can pose a challenge, and there is no one simple solution. One approach may be to take the daily interest cost or the capital cost of the project as of the completion date. Another approach might be to evaluate the cost based upon the value that the project is intended to ultimately provide the user.

Another approach for liquidated damages is to have a step, or tiered, liquidated damages provision by which the daily rate increases after certain milestones have not been met. For example, an owner may charge one price for a major delay and another price for a minor delay; or may charge one price for the completion of certain buildings and another price for the completion of other buildings. This approach may allow the owner to avoid appearing punitive. The owner may also assess one charge for failing to meet a substantial completion date and another rate for failing to meet a final completion date, at a reduced rate.

2. Enforceability:

So long as a liquidated damages provision does not constitute a penalty, such a provision is generally enforceable. *See, e.g., Kansas Heart Hospital, L.L.C. v. Idbeis*, 286 Kan. 183, 184 (2008); *Standard Improvement Co. v. DiGiovanni*, 768 S.W.2d 190 (Mo. App. 1989). Courts have found liquidated damages to constitute a penalty under narrow circumstances, but generally when the evidence shows that the parties intended to liquidate damages and, at the time of the contract it was difficult to ascertain the amount of the actual damage that would result in a breach, the liquidated damages will be enforced. *Klinger v. Adams Cty. Sch. Dist. No. 50*, 130 P.3d 1027, 1033-34 (Colo. 2006). But in Missouri, for example, if liquidated damages are grossly disproportionate to the owner's actual damages, courts or arbitrators may intervene and refuse to enforce them. *See Goldberg v. Charles Chevrolet, Inc.*, 672 S.W.2d 177 (Mo. App. 1984).

Many contractors mistakenly believe that the owner is not entitled to actual damages if the contractor is assessed liquidated damages, but that is not always the case. *See, e.g.*, *Fagan Constr. Co. v. City of Bonner Springs*, 1999 Kan. App. Unpub. LEXIS 211, at *9 (Kan. App. 1999) ("[a] liquidated damages provision in a contract will not prevent the recovery of actual damages for other items to which the liquidated damages provision does not apply, unless the contract expressly provides that damages other than those enumerated shall not be recovered"). The Colorado Supreme Court has held that liquidated damages provisions which allow the non-breaching party to elect whether to pursue liquidated damages or actual damages are not an unenforceable penalty, but the non-breaching party may not seek both types of damages under those circumstances. *Ravenstar v. One Ski Hill Place*, 2017 CO 83, 2017 Colo. LEXIS 792, at *16 (Colo. 2017).

Owners should adhere to the following principles to limit the risk of having an unenforceable liquidated damages provision: (1) avoid using the word "penalty" or similar terms when referring to these types of damages in the contract; (2) if the damage figure seems high, then include specific language explaining the importance of the project's timely completion, the serious nature of the harm in the event the project is delayed, and the specific types of damages that will be suffered; and (3) offering an early completion bonus to the contractor.

3. Notice of Claim Requirements:

Most construction contracts require parties who wish to assert a claim to provide prompt notice to the other party of that claim. The AIA documents contain many sophisticated schemes of notice, most of which apply when a contractor encounters a field condition that will delay the work or cause cost overruns. The typical clause requires notice of a claim within a certain number of days of the time the claimant learns of the facts leading to the claim and, in any event, prior to the date on which the claimant begins to expend extra funds for which it will seek compensation.

Several reasons exist for including notice of claim requirements, including:

1. Notice of a claim gives the recipient an opportunity to gather information relating to the claim before it is lost. For example, a notice may allow the parties to

measure, photograph, or sample a buried structure or rock that the claimant claims will lead to additional costs. If the recipient of a claim is not given proper notice, the claimant may remove the rock or the structure before the recipient had the chance to preserve evidence that may very well govern entitlement to the claim.

2. Notice may enable the parties to reach an agreement regarding the amount of the loss and the claim after prompt investigation and thus avoid further claims and litigation.

3. Notice requirements may help "weed out" claims that do not appear genuine. Recipients of claims often believe that once the claimant completes the project and discovers that the project lost money, the claimant begins asserting claims to recoup that loss. Requiring and providing prompt notice at the time of the event in question helps avoid afterthoughts and negative inferences or assumptions.

4. Recipients of the claims have to manage and budget their own portion of the construction project and must make decisions based on the information available to them. If the recipient does not learn until later in the job that there are anticipated cost overruns, it will be less flexible to arrange financing, manage the budget, make alterations or changes in the project design, or exert other efforts to save the money that may be needed to cover the claims.

Claimants sometimes try to circumvent the notice requirements by arguing that it would be inequitable to enforce technical requirements of a notice clause where the purpose of the clause, in fact, has been met; such as where minutes of job meetings confirm actual discussions and consideration of a potential claim. But merely showing that the recipient had knowledge of the field condition at issue may not sufficiently prove compliance with the notice clause. For example, if a recipient is aware that the contractor has encountered an underground condition that is slowing the progress of the work or is costing extra money to remove, that does not necessarily mean the recipient understands the actual nature of the condition or the extent that such condition will impact the project, or that the contractor considers the condition to be an owner-related problem. This distinction is important, because if the contractor plans to effectively spend the owner's money, then the owner is

entitled to direct whether and how to proceed, how much to spend, modify or question any design issues, and dictate the of means and methods of completing additional necessary work.