

**RISK ANALYSIS:
HOW DESIGNERS
AND CONTRACTORS
MINIMIZE CONSTRUCTION
LITIGATION**

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I. INTRODUCTION

“I was never ruined but twice: once when I lost a lawsuit, and once when I won one.” So said Voltaire, reflecting on his own litigation experience.

No doubt, virtually all participants in the construction industry would agree with Voltaire’s observation and most probably have some personal experience on which they base their belief that construction litigation is inevitable, costly and non-productive.

However, while the twin goals of avoiding construction litigation and making it less costly are worthwhile and should certainly be pursued, we should not lose sight of the fact that construction litigation is not a new phenomenon. While each generation in the construction industry seems to recall a happier, more idyllic era when there was no construction litigation, the fact is that construction litigation is, and always has been, an inevitable by-product of the construction industry. For example, in the late 19th century United States, the significant expansion of railroad lines generated substantial construction litigation. This can be verified by reviewing appellate reports from any of the states. Many of the cases appealed were the result of disputes between builders and railroads.

Generally speaking, periods of strong economic growth seem to be accompanied or followed by periods of increased construction litigation. Perhaps the most recent example of this was the speculative office building boom in the mid- to late-1980s. Another recent, though earlier, example was the inflationary period of the 1970s. The new interest in and use of design-build could be the next source of increased construction litigation as participants in the design-build industry grapple with the novel and unfamiliar liability issues created by design-build as a method of project delivery.

The inevitability (and history) of construction litigation should not dampen efforts to avoid (or at least minimize) construction litigation and reduce its cost. However, such efforts should be realistic and should not lose sight of the fact that as long as there will be construction, there will be disputes, and as long as there will be disputes, there will be litigation.¹

II. THE CAUSES OF CONSTRUCTION LITIGATION

It is axiomatic that those who wish to avoid, and at least minimize the cost of construction litigation, must identify its causes. However, construction litigation is caused by a variety of factors, not all of which are as easily controlled by the participants in the construction industry. For example, a considerable amount of construction litigation results from regulatory requirements imposed by the federal government and the states. This includes OSHA and its state counterparts, environmental legislation and requirements (for example, wetlands and hazardous waste disposal), affirmative action programs, nondiscriminatory sexual hiring policies, and other social regulatory schemes.

In addition to the litigation generated by statutory and regulatory requirements, there is a substantial amount of litigation which results from third-party tort actions. The pervasive use of indemnification clauses in the construction industry multiplies the impact of a tort action initiated by the injured worker or, in case of death, the estate of the injured worker.

Indemnification creates a “ripple effect” in terms of spawning additional litigation between indemnitors and indemnitees, often on a multiple level (sub-subcontractor, subcontractor, prime contractor, owner and the like).

Nevertheless, even if the analysis of the causes of construction litigation separates out regulatory and third-party tort action litigation, the fact remains that there is substantial

¹At least some comfort may be taken in the fact that the legal system has progressed to the point where all that is at risk in modern construction litigation is money and not life or limb. For example, the Code of Hammurabi provided that “If a builder builds a house for a man and does not make its construction firm, and the house which he has built collapses and causes the death of the owner of the house, that builder shall be put to death.” R. Harper, The Code of Hammurabi, § 229, et seq. (1904). This is merely a reflection of a greater or societal reality: as our civilization has developed, we have resorted to the courts to resolve disputes and not to violence. This is deemed progress.

construction litigation which has its genesis in contract and/or performance disputes. This is the “true” construction litigation about which the construction industry has always been concerned, and properly so.

Unfortunately, it is in the nature of a construction project and the negotiation and drafting of a construction contract that litigation is inevitable to some degree or another.

Negotiating and drafting a construction contract ultimately is an attempt by the parties to define in words (which often have different meanings to the parties) the scope of work to be performed. The likelihood that a given construction contract will accurately reflect the mutual intentions of the parties is no greater than the ability of the parties to understand one another and to select language which reflects their mutual intentions and understandings. Inherent in this process is the possibility of genuine good faith disagreements over the meaning of the language chosen to reflect the intentions of the parties as set forth in their contract.

Even if the parties are reasonably successful at reaching a mutually-shared understanding of what the contract will require and translating that understanding into words which articulate their mutually-shared understanding, performance of the contract is subject to external factors over which the parties have incomplete control or, indeed, no control whatsoever. The reality is that often, such factors create risks which the parties did not contemplate, or contemplated but never reached agreement on how to deal with such risks and their allocation among the parties. Even the most carefully planned and executed contract, therefore, can be exposed to the stress of unforeseen events and/or events which could have been foreseen, but which were not adequately dealt with in the contract language. Since these events ultimately have an economic impact on the progress of the work, they expose the parties individually to financial loss. Therein lies a principal reason for construction litigation.

III. A CAREFUL ANALYSIS SHOULD DISTINGUISH BETWEEN THE CAUSES OF CONSTRUCTION LITIGATION AND THE FACTORS WHICH CAUSE CONSTRUCTION LITIGATION TO BE COSTLY.

To use resources wisely in furthering the goal of minimizing construction litigation without handicapping the industry in the process, we must be cognizant of the differences between the factors which cause construction litigation versus the reasons why construction litigation tends to be costly. Greater and more immediate benefits may be obtained by focusing on one as opposed to the other, and the available resources are not unlimited for dealing with both.

Among the more important causes of construction litigation are the following:

- a. Risks which are often practically unmanageable.
- b. Personalities of the participants which often reveal tendencies of aggressiveness, greed, career development and other personal interests.
- c. Accuracy of the design documents made part of the contract.
- d. Risk-shifting contract language.
- e. Society's predilection to view complex legal and factual issues in terms of black-and-white.
- f. The nature of the construction-pricing system and the predominance of the competitive bid process.
- g. Pure nonpayment issues which often result in one party attempting to spread the pain among the other parties.
- h. The "gap" between the standards of care owed by the designer to the owner, the contractor to the owner and the owner to the contractor.

A detailed analysis and discussion of each of these causes would identify some specific methods by which to minimize the effect of the cause as a generator of construction litigation. The causes, however, are susceptible to varying degrees of management. For example, while a design firm or a construction company could be careful in hiring non-aggressive persons, all would agree that some amount of "aggression" is desirable insofar as the successful performance of a construction project requires people who are "movers and shakers." As another example of the practical limits in managing the causes of construction litigation, the competitive bid system is still very much in place in the United States and is likely to remain so, despite the popularity of design-build in today's construction market. Finally, the "gap" in

the standards of care is the result of judicial decisions based upon fundamental legal principles and these principles are not likely to change in the near future.

The two approaches traditionally taken to minimizing and/or managing the causes of construction disputes might be easily and effectively summarized as “fair versus unfair risk allocation methods.” Some participants in the industry have decided that the best way to avoid construction litigation is to allocate all possible risk to the other person. While the avoidance of construction litigation is the professed goal of this risk allocation approach, the underlying reason might well be the hope that if construction litigation is inevitable (as it is often perceived to be), then the “unfair” approach is likely to maximize the recovery or defense of the person who takes that approach. Inherent in this approach is the belief that the potential adversary, at the time the dispute arises, will perceive that the contract is so one-sided that the adversary will not raise the dispute, or at least will not pursue it to litigation where the adversary knows it will lose.

The other approach of “fair” risk allocation assumes that parties are more likely to avoid costly litigation and the disputes which generate such litigation if the parties have an equally-shared perception that their agreement, and their relationship, are fair. Unfortunately, and traditionally, there have been participants in the construction industry who automatically gravitate toward the unfair risk allocation approach and would not consider for a moment taking the other approach. While the “success” which partnering has had (at least based on anecdotal evidence) would tend to suggest that greater use of fair risk allocation reduces construction disputes, that notion is unlikely to ever be shared by all participants in the construction industry, human nature being what it is. Indeed, the attempts that have been made in the past by the Associated General Contractors of America and the American Subcontractors Association to draft model subcontract documents are perhaps more persuasive evidence that there is, as of yet, no large sector of the construction industry strongly behind the idea of avoiding construction disputes by pursuing fair risk allocation in contract documents.

There are two opportunities to avoid (or at least minimize) the causes of construction disputes and the cost of construction litigation. These two opportunities are self-evident and yet

experience shows that the participants in a construction project often ignore the first opportunity when it is the one most important to them.

The opportunities are, simply, before the contract is signed, and after the contract is signed. Far too much attention is paid to the opportunities which are presented after the contract is signed and performance is underway to avoid the causes and costs of construction litigation. Too little attention is paid to the importance of the period before the contract is signed to achieve these goals by careful contract review, contract negotiation and contract drafting. Indeed, to the extent that any attention is paid to the pre-contract phase as an opportunity to control the causes of disputes and the cost of litigation, it is the portion of the industry which deems unfair risk allocation to be beneficial which is most likely to focus on this phase.

The cost of construction litigation may be explained by different factors. Some of these factors are more susceptible than others to control and management and generally cost factors are subject to greater control than cause factors. While attention should be devoted to cost factors, which certainly has been the case in the last ten years, focus on cost factors tends to neglect cause factors and careful attention to cause factors can be as productive in reducing construction litigation as attention to cost factors is likely to reduce the cost of construction litigation.

Some of the more important factors which contribute to the cost of construction litigation are these:

- The number of participants in the project — On any construction project, there are a number of parties who are inevitably drawn into the dispute. In a typical nonconstruction commercial dispute, there are usually only two disputants: buyer and seller. In the construction industry, however, there are many more participants: owner, architect, engineer, general contractor, subcontractor, sub-subcontractor, supplier and surety. It is in the nature of litigation and risk allocation that all of the construction industry participants are drawn into the litigation which has a multiplier effect on litigation expense.

- The number of documents required for a construction project — Even medium-size construction projects tend to create innumerable documents from the time the design of the project begins until the time the project is completed and occupied. The transmittal letters, project reports, correspondence, submittals, shop drawings, RFIs, change orders, change order proposals, daily reports, proceed orders, field memoranda, and other documents generated by a construction project create a voluminous record in which the individual disputants often can each find more than a kernel of truth to support their respective positions. The documentary record, therefore, becomes a major cause of costly litigation.
- Standards of proof — The standards of proof required in litigation contribute to the cost of a construction lawsuit. Attorneys must necessarily be careful to ensure that the evidence they present for their clients meets the standard of proof imposed by the law under which they operate. This factor, in combination with the volume of construction documents, tends to prolong and make more expensive both the discovery process and the ultimate lawsuit itself.
- Discovery — Discovery is yet another reason why construction litigation is costly. Given the number of participants, each of whom may have at least several employees involved in the project, given the sheer volume of documents, and given the standards of proof and the degree of preparation which attorneys feel they must reach and which their clients insist that they reach, the discovery process has become the single most costly phase of construction litigation.
- Civil litigation delays — Delay in going to trial contributes to the cost of construction litigation. The mere fact that a construction lawsuit is not tried until many months, if not years, after it is first filed inevitably increases all parties' costs. Yet litigation delays in state and federal courts, often the result of the priority given to criminal matters and the fact that construction lawsuits compete with other civil matters for the attention of a limited number of judges means that construction matters are put at the end of the calendar!

- The need for expert testimony — It is a standard feature of construction litigation today that both sides retain experts on so-called expert issues. This further increases the cost of construction litigation as experts must be paid and prepared for trial. It is in the nature of an expert's preparation that the expert must be familiar with all of the voluminous documents and other sources of fact information on which he will base his opinion. This means that the use of experts increases construction litigation costs.

As to the cost of construction litigation, the goal is quite simple: make dispute resolution in the construction industry less costly.

IV. PRACTICAL METHODS TO IDENTIFY AND MITIGATE POTENTIAL RISKS THAT CAN LEAD TO CONSTRUCTION LITIGATION

What is needed is a comprehensive approach to analyzing the risks which are the causes of construction litigation. The approach must be as comprehensive as possible so that all risks (or at least as many as possible and are likely) can be identified in advance and dealt with and/or mitigated by either contract language or contract administration.

a. Risk

A risk is the chance of injury, damage or loss. Risk management refers to the art and science of identifying, analyzing and responding to the chances (or causes) of loss on a construction project in a manner which, ideally, best achieves the objectives of all members of the construction team: on-time, on-budget completion without litigation. Risk management involves the allocation or transfer of the risks inherent in a construction project between the contracting parties. If done effectively, risk transfer does not grossly or inequitably allocate all risk to one party, but instead places risk upon the parties according to their ability to prevent, control and ensure against risk. Additionally, effective risk management generally results in an overall positive effect on the project by improving contract performance, increasing cost effectiveness, and creating a good working relationship between contracting parties. Risk management

should be an important component of the partnering process if that process is to be effectively employed in the best interests of the project.

b. The Contract

The focal point for allocating risk on a construction project is the construction contract. However, to best manage the various risks which the participants face, careful attention also must be given to the other contracts important to the project, for example, trade contracts, subcontracts and design contracts.

The importance of the contract cannot be over-emphasized. Ideally, the contract will assign the risks and liabilities to the party best equipped to manage and minimize them. The contracting process provides the vehicle for each party to negotiate, define and limit his rights (and risk) in accordance with the goals he seeks to accomplish. The risk and responsibilities associated with a specific project must be clearly allocated within the contract. In the end, the contract serves as the framework of the law between the parties and will establish which party has assumed the risk or negated a particular risk in connection with the project. Indeed, as noted below, even where risk arises out of a negligence claim brought by a person with whom a party has no contract, the contract will be significant in defining the party's duty to such a person.

c. A Risk Management System

1. Although the contract serves as the principal risk management vehicle, the management and minimalization of risk should begin long before the contract is signed. Risk management is the responsibility of both contracting parties. To avoid inequities, both parties should come to the negotiating table with at least some idea of their risk management goals.
2. Unfortunately, many participants in the industry pay insufficient attention to the risk management process. Contractors and designers, for their own protection, must set risk management goals and implement risk management procedures in order to control their exposure to unwanted risks and liabilities. Contractors and

designers, likewise, must undertake the same exercise in order to not only protect themselves, but to act in the best interest of the client, as well.

3. Risk management requires a systematic and practical method of dealing with both the predictable and uncertain risk inherent in the construction industry. Risk managers must acquaint themselves with the risks they are to manage and develop specific risk minimalization strategies. Risk management typically involves the following functions:
 - a. Risk identification — Prior to negotiation, someone must be responsible for the identification of contractual and extra-contractual risks. Risk identification is the essential first step for a successful project and protection against risk. The risk factors comprise the characteristics of a risk, such as the risk event, its probability of occurrence, and the amount of potential loss or gain attendant upon the risk. Risks influence all aspects of a project including cost, schedule, quality and profit, but the impacts can be controlled to the extent the risks are effectively identified and then managed.
 - b. Impact analysis — The risk manager must quantify the impact a risk will have on the project cost, schedule, quality and/or profit.
 - c. Response system — The risk manager must develop a process for formulating risk management strategies — identification, mitigation, deflection and contingency planning. Deflecting or transferring risk by contract is a common response technique ranging from total allocation of risk to another party, risk-sharing between two or more parties, self-insurance against the risk or insuring the risk on a commercial basis. Project management requires education in the area of risk management through contract provisions. Often, project management does not realize the significance of effective risk management through the vehicle of

contract negotiation and contract drafting and contract review during performance.

- d. Application of risk management techniques and tools during contract administration — Only if the risk management process is implemented during construction will the parties receive the full benefit of the risk allocation system, contract provisions and other tools which are available to protect them. Proper contract administration, from the perspective of the construction risk manager, includes effective and timely information gathering and dissemination systems, monitoring the performance of those who pose risks and/or to whom a party may be liable, enforcing contract provisions designed to minimize risk and taking early action to identify and control those risks which become real as the project unfolds.

V. A FRAMEWORK FOR ANALYZING AND MANAGING CONSTRUCTION RISK

Risk management for the construction industry begins with a survey of the types of risk and sources of risk which the industry participant faces. Of course, risk will be peculiar to the particular project and participant (e.g., designer, contractor, owner), and each project will have its own unique set of risks. Notwithstanding, all construction projects share common risks: delays, claims for increased cost, injuries to workers and the like. One of the first steps in identifying risk is to catalog the risks posed by the project. To be certain that this is done on a comprehensive basis, the industry participant should analyze risk from a number of different perspectives including the following:

- What services he or she will furnish to the client.
- Who poses a risk to the contractor/designer/owner?
- What are the potential damages which the participant faces if the risks identified actually materialize despite their best efforts to avoid/manage them?

If the question of risk identification, allocation and management is viewed from each of these perspectives, the participant is far more likely to identify, and thus be in a position to

deal with, all likely risks on the project. This approach further ensures the likelihood that the risk management systems created to deal with risk are more, rather than less, effective.

A. Analyze the Services Provided by the Contractor/Designer/Owner for Their Associated Risks.

A good place to start examining the risk which the participant faces is to review the scope of work and/or the services he/she is to provide the client or other party and then identify the team members whose performance depends upon such services. Inherent in each service or scope item is one or more risks. The major risks usually are scheduling and coordination of the work and cost management and control. Of course, the performance of design services poses certain risks necessarily associated with the provision of such services which need to be identified and managed. However, whatever the responsible party has undertaken to do, the point is the same: carefully analyze the services which he or she has been asked to perform in order to understand what risks are being assumed in offering such services.

B. Given the Services Provided, Who Poses the Risk?

From this perspective, the contractor/designer/owner asks who poses the risk which must be managed? Stated differently, who is the potential adversary should a risk materialize?

On a construction project, there will typically be two categories of "risk-presenting persons." These categories are (1) those with whom the participant is in privity of contract and (2) those with whom the participant is not in privity of contract. Each team member will fall into one of these categories.

1. Persons in Privity of Contract

First and foremost among this category is the participant's client, the owner. However, depending upon how the project is organized, there may be other persons in privity ("privies") who pose risk to a party. These include trade contractors (if the contractor holds trade contracts) and consultants or designers (if the contractor has retained such persons).

The risk normally presented by persons with whom the party is in privity is the risk of breach of contract, that is, any privity legally may assert a breach of contract claim against the other contracting party. The claim would emanate from the allegation that a privity has breached any one or more of the duties assumed under his contract by failing to provide his services with the requisite degree of skill and care expected of a person offering such services.

a. Issues in Managing the Risk Posed by Privies

- (1) Contract defenses — e.g., notice requirements.
- (2) Standard of care — e.g., the standard of care is contractually limited.
- (3) Limitations of liability — e.g., "no damages for delay" clause.
- (4) Risk allocation — e.g., the other party assumes the risk via an indemnification clause.
- (5) Disclaim warranties — e.g., no warranty attends the budget or schedule.

2. Persons Not in Privity

On any project, a party is exposed to risks presented by persons with whom the party is not in privity of contract ("non-privies"). Such persons typically include construction workers, trade contractors (if the owner does not hold trade contracts), subcontractors, visitors to the site, lenders and sureties.

The principal risk posed by non-privies is the risk of negligence claims. Because persons who are not in privity cannot sue for breach of contract, their claims are likely to be asserted on the basis of negligence theory, namely, that a party owed such persons a duty to act prudently and with the requisite degree of skill and care (i.e., it was foreseeable that they would rely on the party), and that as a result of the breach of such duty, the non-privity incurred damages which were proximately caused by the party's breach of its duty.

In addition, non-privies may pursue claims based upon the "third-party beneficiary doctrine" under which the non-party asserts that it is the intended beneficiary of the contract between the others. A number of courts have upheld third-party beneficiary claims in a construction context. See, for example, Westerhold v. Carroll, 419 S.W.2d 73 (Mo. 1967: privity of contract was not required to enable surety's indemnitor to recover against architect who incorrectly certified the amount of work completed and the amount of materials furnished); Barth Electric Co. v. Traylor Bros., Inc., 553 N.E.2d 504 (Ind. App. 1 Dist. 1990: electrical contractor was a third-party beneficiary to the contracts entered into by other contractors and public school board); Tonn & Blank, Inc. v. Board of Commissioners of Laporte County, 554 N.E.2d 827 (Ind. App. 3 Dist. 1990: contractor held to be third-party beneficiary of contract between owner and parallel prime contractor for jail project); Moore Construction Co., Inc. v. Clarksville Department of Electricity, 707 S.W.2d 1 (Tenn. App. 1985: co-prime contractor held to be third-party beneficiary of contract between public utility and another co-prime contractor); and Hanberry Corporation v. State Building Commission, 390 So.2d 277 (Miss. 1980: surety entitled to claim as third-party beneficiary against any of the other co-prime contractors who caused losses to surety's principal).

a. Issues in Managing the Risk Posed by Non-Privies

Due to the absence of a contract between a party and the non-privy presenting the risk, it is more difficult to control the risks posed by non-privies. Moreover, the law generally sets a limit on what any person can do to immunize himself against tort claims. Nonetheless, there are risk management techniques and legal principles available to deal with the risks posed by persons with whom one is not in privity. These include the following:

- (1) The economic loss doctrine — See, for example, Long Island Lighting Company v. Stone & Webster Engineering Corporation, 839 F.Supp. 183 (E.D.N.Y. 1993: in the utility's lawsuit against a construction manager for defects in three diesel generators, the utility could not maintain a claim for gross negligence where the damages it seeks are economic in nature); and Fleischer v. Hellmuth, Obata & Kassabaum, Inc., 870 S.W.2d 832 (Mo. App. E.D. 1993: architect was not liable to a construction manager for damages for economic losses arising as a result of architect's negligent performance of its contract with the owner).
- (2) "Foreseeability", i.e., establishing that no duty was owed to the person claiming a loss.
- (3) The standard of care — the party properly performed his duties.
- (4) Indemnity and hold harmless agreements — allocate the ultimate risk to others.
- (5) Insurance — insure against the risk.
- (6) Qualified privilege — the party has a definite legal right to critique the performance of a team member. See, for example, Fleischer v. Hellmuth, Obata & Kassabaum, Inc., 870 S.W.2d 832 (Mo. App. E.D. 1993)

Despite the above, however, construction industry participants must face the reality that some risks are likely to seep through even the most carefully-created and executed risk management system. Such inescapable risks are to be insured against if possible, or self-insured, if no other option is available.

C. Analyze the Risk by Considering Potential Damages.

As another perspective from which to analyze the risks associated with the project, the party should consider the damages to which he could be subject if a risk is realized. The damages which a party might face are typical of those seen on any construction project and include the following:

1. Delay damages, for example, the field and home office overhead costs associated with extended contract performance, or increased financing costs.
2. Lost efficiency, that is, the increased costs associated with the performance of trade contractor (or subcontractor) work in a disrupted and out-of-sequence basis.
3. Cost overruns due to changes, errors and omissions in the design documents, bad estimates, trade contractor/subcontractor defaults and similar events.
4. Loss of anticipated profits; for example, this might originate from a delay in completion of the project as a result of which the owner/client is unable to lease space, begin manufacturing or otherwise use the project for its intended purpose. However, for loss of future profits to be recoverable, they cannot be speculative. See, for example, Kenford Company, Inc. v. County of Erie, 493 N.E.2d 257 (1986).

By looking at the types of damage for which a party may be at risk, the party can set about to control the risk. Thus, delay damages may be precluded by the contract, for example, by means of a "no damage for delay" clause. Other types of damages, for example, increased financing costs, can be avoided by a provision stipulating liquidated, as opposed to actual, damages for delay.

D. Develop a Comprehensive Approach to Identifying Risk.

By analyzing each construction project from the perspectives of (1) the services to be provided; (2) the persons who present risk; and (3) the potential damages which the party might suffer, the contractor/designer/owner is apt to have a much greater appreciation for those risks likely to be faced. Knowing the risk is the first step in dealing with risk. Once the risk has been identified, the party has an array of effective tools at his disposal to manage the risk. He can also decide which risk he simply must absorb and, then, take steps to ensure that contract administration methods are created and executed to maximize the likelihood that self-insured risks will be adequately controlled.

E. Develop a Risk-Response System.

In the pre-performance phase, and after the risks have been analyzed, the next step is to develop a risk-response system. This should occur and be refined in three distinct phases: (1) before the contract is signed; (2) after the contract is signed but before mobilization, and (3) during project performance.

Before the contract is signed, the designer or contractor or owner should review the bid documents for clarity, to identify ambiguities and to ensure the documents are consistent. In addition, contingencies should be established for identifying significant risks.

Based upon a review of the documents, contract language should be negotiated accordingly and steps taken to ensure that all contract documents are reciprocal, namely, that the risks assumed by the contractor are reflected in the subcontract documents.

This is also the stage at which a decision must be made as to where on the fair-unfair risk allocation spectrum the party feels comfortable. Again, based upon that decision, appropriate contract language must be drafted to deal with at least the following issues:

- Notice of claims.
- Waiver.
- Limitation of liability.
- Liquidated damages.
- No damages for delay.
- Attorneys' fees.
- Interest.
- Notice of disputes.
- Remedies.

Disclaimers and/or exculpatory clauses can be inserted in the contract to reduce the causes, extent and cost of construction litigation. The use of such disclaimers is not necessarily a sign that the party drafting the documents has chosen to pursue “unfair” risk allocation:

The key to enforcement of any of these [exculpatory] clauses is in determining whether the contractor can protect himself in preparing his bid by including a reasonable contingency in his price. If such a contingency can be determined from the facts disclosed by the Government, the clause should be enforced.... Stated another way, a disclaimer clause which alerts the contractor to known or anticipated defects in the specifications is a reasonable device because it contributes to more intelligent pricing of the contract. This type of clause communicates information to the contractor in a very useful way. In contrast, a disclaimer that merely throws some unknown risk on the contractor is no more than an invitation to participate in a gambling venture.

Government Contract Changes, R. Nash at 283 (1975)

If the party drafting the documents wishes to provide for alternative dispute procedures, such procedures must be set forth in the contract so that they become binding on all of the parties.

Further, if the basic contract documents are boiler-plate documents, for example, AIA Documents, then attention must be paid to the unique needs of the parties and the project, and the risk allocation approach being taken by the parties

which may not be reflected in such standard form documents. Again, careful review of all of the contract documents for consistency of intent and purpose is essential.

The next stage at which the risk response system should be reviewed is after contracting and in preparation for mobilization. This is the point at which project management staff (field and office) must become familiar with the risks posed by the project, the risks posed by the contract documents, the notice requirements of the contract documents and important contract provisions generally. At this point in the process, project management becomes the single most important and effective resource for minimizing the causes of construction litigation. If project management is not familiar with notice requirements, remedies, disclaimers and other important contract provisions, they will not be able to use or resist these provisions in the best interests of their company and in the interest of avoiding construction disputes.

The last phase, project performance, also offers opportunities to avoid or minimize the causes of construction disputes. Important to the effective use of a risk response system in this phase is management oversight. Senior management (above the project and field levels) must periodically ensure that all required notices are being given, that problems are identified early, and that a resolution of such problems is undertaken as soon as possible. The performance of project management toward achieving these goals must be monitored. Senior management must ensure that information systems are in place so that events which pose a risk are promptly identified, that notice to affected parties is promptly given, and that senior management itself receives timely notice so that it can begin its oversight and monitoring functions. During this phase, the key is follow-up to ensure that potential issues which could be the subject of a lawsuit are (1) identified as early as possible so that they (2) can be resolved without litigation.

The comprehensive approach to analyzing risks and the development of a risk response system (as outlined above) can be utilized effectively by each of the three important groups involved in virtually every construction project: owner, designer,

contractor. Designers, however, have other opportunities and challenges to minimize the causes of construction litigation. These include the following:

- (1) Careful plan check and coordination of the design documents.
- (2) Careful review and coordination of the contract documents (general conditions, supplementary general conditions, special conditions and the like).
- (3) Careful notice to the client of the constraints imposed on the designer by fee.
- (4) Ensuring that there are sufficient funds for contract administration if the designer is to serve in that phase.
- (5) Careful attention to project correspondence, job meetings and the like.
- (6) Prompt resolution of issues once notice is given.
- (7) Fair and impartial decision-making.
- (8) Follow-up and oversight of continuing disputes until they are resolved.
- (9) Client education as to the “gap” in standards of care.

As is the case with the contractor, the key to the success which the designer will have in minimizing the causes of construction litigation is early identification and resolution of construction problems.

VI. CONTROLLING THE COST OF CONSTRUCTION LITIGATION

As suggested at the outset, some construction disputes will survive the most determined efforts to avoid them in the first instance and then to settle them amicably and without resort to litigation. Therefore, in the pre-contract phase, attention should be paid to how such disputes will be resolved if they cannot be negotiated and settled. The contract must contain dispute resolution systems or remedies. Once a dispute arises and the positions of the parties become

entrenched, it will be far harder to agree upon an efficient method of dispute resolution if that method is not already prescribed by the contract.

With a view toward minimizing the cost of resolving construction disputes, the parties should agree, in their contract, upon a multi-step and efficient disputes process which aims at requiring the parties to identify disputes early, pursue the resolution of disputes at the basic level first and continue to pursue those disputes which cannot be resolved rather than merely put them off until the end of the project.

The disputes process should be multi-step, i.e., progress through several different defined stages as necessary. Once a dispute has been acknowledged by notice of a claim or notice of a dispute, the first stage should be negotiation by those persons at the field level most familiar with the facts and circumstances of the dispute. The parties should agree upon a defined period of time in which such negotiations will occur once the dispute has been properly noticed. If the dispute is not resolved at that level, the parties' contract should define the next level and method of dispute resolution. This could be a dispute review board, dispute resolution advisor, neutral mediator, etc. Again, whatever the process chosen as the second step, the period in which that process will be pursued must be clearly defined.

Those disputes which cannot be resolved at the first or second levels should then be pursued to resolution at a third level. Depending upon the parties' preferences, the third level should be binding arbitration under the Construction Industry Rules of the American Arbitration Association. Where the parties are sincerely interested in efficient and expedient resolution of those disputes which cannot otherwise be resolved and where the parties are as desirous of saving money in resolving construction disputes as they are in winning a dispute, construction arbitration under the AAA Rules is a practical, familiar way to achieve the ultimate goal of reducing the cost of resolving construction disputes. Despite the complaints made about construction arbitration, on the whole, it remains a far more efficient dispute resolution process than litigation in a civil court. Most of the important perceived problems of construction arbitration can be resolved at the contract drafting and negotiation stage. For example, the

language of the arbitration clause can be modified to provide for the consolidation of all disputes by all persons in a single arbitration.

Other alternative dispute resolution procedures simply do not offer the finality of an arbitration award following the conclusion of arbitration hearings. Partnering, mediation, neutral evaluation and the like may be effective, from time-to-time, in resolving some disputes. As to those disputes which cannot be resolved in some type of non-binding procedure, the parties are left with only two options: litigation with all of its costs and arbitration with the opportunity it presents for a fair (not perfect) reasoned decision by competent, experienced people at a significantly lower cost to the parties.

It is unfortunate that the new Construction Industry Arbitration Rules effective April 1, 1996, particularly the Rules adopted for large complex construction cases, provide the arbitrators with some additional discretion directing discovery by ordering depositions or interrogatories. Rule L-5, Management of Proceedings, states the following in subpart (c):

The arbitrators upon good cause shown may order the conduct of the deposition of, or the propounding of interrogatories to, such persons who may possess information determined by the arbitrators to be necessary to a determination of Large Complex Construction Case.

This change was the result of the belief by persons who have participated in construction arbitration that the process suffered from the inability of the parties to compel some amount of discovery in arbitration. If in the years ahead more and more construction industry arbitrations are accompanied by depositions and interrogatories, one of the principal benefits of arbitration — its relative lower cost vis-s-vis litigation — will be eroded. In anticipation of this problem, when drafting an arbitration clause in the pre-contract phase, the parties may wish to agree that there shall be no discovery in the arbitration other than that clearly allowed by the Construction Industry Arbitration Rules, namely the exchange of information and the production of documents and the identification of witnesses as required by Rule R-10, Exchange of Information.

VII. SUMMARY

In the effort to avoid disputes and to mitigate the cost of resolving those disputes which cannot be avoided, the construction industry should not lose sight of the reasons why construction disputes are inevitable. The effort needs to be tempered with a dose of realism so that what results is not frustration and disappointment but a sense of accomplishment based on reality.

Good contract drafting and effective contract administration will always offer the best opportunities for identifying and controlling the causes of construction disputes and for resolving them. In the haste to find an early solution to the problem in the form of new types of dispute resolution processes (i.e., ADR), care should be taken not to forget the fundamentals.

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