

Mitigation of Construction Defect Litigation- Top 10 Construction Contract Issues

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When negotiating a construction contract with a general contractor (GC), the owner/developer should be aware of, and address, a number of issues to attempt to mitigate or limit the risk of construction defect litigation for a residential project, including multi-family and for-rent residential apartment and senior housing projects. The standard forms of construction contract—such as the American Institute of Architects (AIA) or ConsensusDocs—are more beneficial to the contractor than the owner in many respects. A construction contract will need to be reviewed thoroughly and revised to better protect the owner, and in the case of residential construction, should in particular, address the following top 10 key issues:

1) **Scope of Work**—The scope of work should be well-defined, accurate, comprehensive and identify the basic components of the project. The scope should not be based solely on the drawings and specifications, which are never 100% complete, and the contractor should agree to reasonably infer the scope of work from the contract documents to produce the intended work. If there is an inconsistency in the contract documents or between the drawings and specifications and contract documents, the contractor should provide the better quality or quantity of the work or materials. The contractor should be required to report any errors, omissions or inconsistencies in the contract documents to the owner. Contractor's work should be subject to inspection by the owner, applicable city, county or governmental entities, and any third-party inspectors retained by owner or construction lender for quality assurance and quality control. Contractor should give advance notice to owner as to specified key system installations—such as soil, foundation, acoustical, exterior, building wrap, HVAC and structural components to allow review and inspection by such third-party inspectors.

2) **Change Orders**—Don't allow material "field changes" from the approved plans and specifications. If there is a question as to the proper way to construct any aspect of the project, such change must be documented through an RFI process by the contractor. If there are changes or selections not specified in the plans or specifications, any change should be documented and approved by the architect and third-party inspectors, if appropriate. Any changes should be documented through a written change order.

3) **Indemnification**—The contract should include a well-written and thorough indemnification and defense obligation by contractor for all construction defect claims and costs, damages, actions, liabilities, judgments and obligations, including investigative and repair costs, attorneys' fees and

costs and consultant fees and costs. The indemnity and defense should apply to all negligent or willful acts or omissions of contractor. The indemnification and defense obligations should survive the expiration or termination of the construction contract through the statute of repose and limitations (eight years in Colorado).

4) **Warranties**—Contractor should warrant that its work is free from defects and will be completed in a good and workmanlike manner. The warranty should commence upon substantial completion of the work and continue through the period of the statute of repose and limitations. The warranty should include any specific warranty provided to residential purchasers by the owner.

5) **Subcontracts**—Contractor should incorporate the terms of the GC contract into the subcontracts and provide a copy to the owner. In particular, the subcontractors should have the same indemnification, defense, warranty and insurance obligations to the GC that GC has toward the owner. Subcontractors should be required to be joined in the same arbitration or litigation action as the owner and any homeowner or homeowners association.

6) **Insurance**—The contract should specify the insurance required and be reviewed by an expert in residential construction insurance. An Owner Controlled Insurance Program (OCIP) or Contractor Controlled Insurance Program (CCIP) are preferred. The OCIP or CCIP should be reviewed to determine if it covers design and construction or only construction. If only construction, the design professionals will need to have proper coverage and limits. The OCIP or CCIP should not contain any exclusions for multifamily, condominium or residential use. Insurance coverage should be maintained through the statute of repose and limitations.

7) **Dispute Resolution**—The contract should specify binding arbitration by a single arbitrator pursuant to the AAA Construction Industry Arbitration Rules or other arbitrator such as DeMars & Associates. However, if a homeowner or homeowners association brings a lawsuit against the owner, then the GC and the subcontractors should be obligated to join such proceedings at owner's request to resolve the dispute.

8) **Compliance with Laws/Environmental Matters**—The GC and subcontractors should be obligated to comply with all applicable laws, rules, codes and regulations, which may include the Americans with Disabilities Act of 1990, and all applicable environmental laws related to hazardous substances, storage and disposal of hazardous materials. The contract should require that the work be completed free of mold or fungi or unacceptable moisture levels.

9) **Construction Lender**—Contractor should be required to satisfy requirements of the construction lender including payment schedule, lien waivers, affidavits and inspections.

10) **Damages/Attorneys' Fees**—An owner should not waive its right to consequential damages, even if the waiver is "mutual" in the contract. Such a waiver is not "mutual" because it harms an owner, who has mainly consequential damages, more than the contractor, who has mainly direct damages. Don't be fooled by the "mutual" language in the contract. In addition, owners should consider whether to add a provision to the contract providing the prevailing party in any action under the contract to its costs and expenses, including attorneys' fees and consultants' fees and experts' fees arising out of any claim or action associated with the contract and be applicable to trial or arbitration and appeals.

This article is not intended to be an all-inclusive list of revisions that should be made to a construction contract for the benefit of an owner/developer. Owners/developers should consult with an attorney

well versed in construction contracts.

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