At a glance: construction contracts and insurance in USA

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Contracts and insurance

Construction contracts

What standard contract forms are used for construction and design? Must the language of the contract be the local language? Are there restrictions on choice of law and the venue for dispute resolution?

Many different form contracts are utilised. The most widely used form contracts are those published by the American Institute of Architects (AIA), which has developed contracts not only for architectural services, but also forms commonly used by owners, contractors and construction managers. Its A201 document, which sets forth general conditions of contract for general construction contracts, is unquestionably the most commonly used document in the industry and is often attached to customised contract forms that are not written by the AIA. In addition to the AIA series of contracts are the 'ConsensusDOCS' construction documents, which were developed jointly by 22 owner, contractor, designer and surety organisations, including the Associated General Contractors of America (AGC). These documents purportedly present a more collaborative approach to contractual relationships, and also have several specialised contractual addenda to address the needs of projects that utilise building information modelling or involve 'green' building. Other available industry form contracts that are less widely used are those published by the AGC, which are generally considered by many to be more favourable to contractors, as well as those published by the Engineers Joint Contract Documents Committee, whose members are representatives of several societies representing professional engineering disciplines and tend to favour the interests of engineers. Moreover, many large owners and developers, governmental entities and contractors also have their own standard form contracts, which they may impose on contractors and subcontractors with little ability to negotiate the terms.

Regardless of the form of contract used, there is no requirement that the contract be written in English, although that is typically the case. In respect of the applicable law and the venue for dispute resolution, federal law and the law of most states generally provides that parties to a contract are free to agree upon the choice of law that governs their contract and the venue for their dispute, as long as the choice of law and venue bear a reasonable relationship to the parties or the dispute. If not, the courts may engage in a conflict of laws analysis to determine the appropriate jurisdiction's law to apply, and as to venue, the court may dismiss or transfer the action to a location that is more convenient for the parties and witnesses. Several states, however, have enacted a special

law that prohibits parties to a contract for a construction project being performed within the state from agreeing in their contract to apply the laws of a different state or to require any dispute resolution to be conducted in another jurisdiction.

Payment methods

How are contractors, subcontractors, vendors and workers typically paid and is there a standard frequency for payments?

Most construction contracts between owners and general contractors and between general contractors and subcontractors provide for payment on a monthly basis, while labourers are traditionally paid on a weekly basis. Payments are typically made in accordance with the contractor's certified requisition for work completed during the preceding monthly period, minus a withholding of usually between 5 and 10 per cent of the amount payable, which the owner or contractor retains until the final payment requisition as security for the contractor's completion of the contract. On fast turnaround projects, such as tenant fit-outs, which only last a couple of months, it is not uncommon for requisitions and payments to be made on a biweekly basis as a means for the contractor to be paid for the first part of the work before the entire project is completed. There is no uniformity or custom for the manner in which payments are made, but it is standard for payments to be made either by cheque or electronic wire transfer.

Contractual matrix of international projects

What is the typical contractual matrix for a major project in your jurisdiction in terms of the contractual relationships among the various construction project participants?

The most common contractual structure is where the owner contracts directly with an architect or engineer for the design of the project and with a general contractor for the construction. The general contractor then enters into subcontracts with all of the trade contractors. However, that structure often varies depending upon the needs or desires of the owner, the project delivery method (design–bid–build, design and build, etc) and pertinent laws. For example, sophisticated owners on large private construction projects are increasingly using construction managers on an 'at-risk' basis to hold all the contracts with the trades and to furnish the completed work at a guaranteed maximum price, or on an 'agency' basis, where the owner contracts with each of the trades separately through the construction manager. In addition, several states have laws requiring public entities on certain improvement projects to enter into separate contracts with each of the major trades (mechanical, electrical, plumbing, general contracting and structural steel), as opposed to a single-source contract with a general contractor.

PPP and PFI

Is there a formal statutory and regulatory framework for PPP and PFI contracts?

There is no general statutory PPP or PFI framework applicable to federal procurements. Legislation enabling these partnerships is either project-specific or specific to a federal agency. For example, the Veterans Administration and the Department of Defense regularly enter into PPPs through their enhanced use lease procurement procedures, and now the US Army Corps of Engineers is authorised to undertake a PPP pilot programme for water and navigation projects.

Although the most significant PPP road projects may be perceived as federal projects (owing to designation of the road as an 'interstate' highway), the reality is that they are state projects administered by the state department of transportation pursuant to state statutes. Nonetheless, there is an important federal component as

these projects often rely on federal funding. There is no common statutory scheme or government approach towards PPPs among the 50 states, but the Federal Highway Administration has a model PPP law for private toll roads that allows for both solicited and unsolicited bids from private developers.

PPPs remain a highly political issue, despite all the reasons for them to flourish in the US. However, as states have a growing need to undertake major infrastructure projects that are frequently estimated to cost in excess of US$1 billion, they are beginning to adopt legislation to permit PPPs on either a state-wide or project-specific basis. At present, there are approximately 39 states that now have some form of P3 legislation, either for transportation or social infrastructure (such as public buildings), or both, and many others have pending legislation. States with a legal framework for PPPs typically exempt them from the traditional procurement rules, which are often too impractical or onerous for PPP proposers and may award a contract based on the best value rather than the lowest bid. Where state agencies consider unsolicited proposals, the PPP laws normally require that final bidding be opened up to other qualified proposers.

Joint ventures

Are all members of consortia jointly liable for the entire project or may they allocate liability and responsibility among them?

Parties to a contract are free to allocate liability as they deem appropriate. Thus, members of a consortium may allocate, in their consortium agreement, the percentage for which each member is responsible for losses or claims against the consortium. Notwithstanding this internal allocation, when contractors choose to operate as a consortium, the consortium is effectively treated, for legal liability and responsibility purposes, as a joint venture or general partnership, which means that each member of the consortium is jointly and severally liable to third parties for the actions of the consortium. Unless a contract with a project owner limits the owner's rights to only seek relief against the assets of the consortium, each consortium member will be liable to the owner (or to any other party with claims against the consortium) for the full amount of the damages claimed. If a consortium member pays more than its allocable share of a claim against the consortium, that member can then seek indemnification from the other consortium members.

Tort claims and indemnity

Do local laws permit a contracting party to be indemnified against all acts, errors and omissions arising from the work of the other party, even when the first party is negligent?

Generally, an indemnification provision in a construction contract is valid and fully enforceable. Such clauses, when properly drafted, may require a contracting party to indemnify the other party not only against the contracting party's negligent acts, errors and omissions, but against the other party's own negligence as well. In determining the extent to which a party is contractually required to indemnify the other, courts in many states look solely to the intent of the parties as gleaned from the terms of the contract. However, before requiring one party to indemnify the other against the other party's negligence, some states require this intent to be stated expressly in the contract, so the indemnifying party indisputably knows that it is, in effect, insuring the other against its own negligence. Regardless of the language employed, some states have enacted laws proscribing parties to a construction contract from being indemnified against their own negligent conduct. In New York, for example, a party cannot be indemnified against claims for bodily injury or property damage, where that party's negligence wholly or partially caused the damage. By contrast, in New Jersey indemnification is only proscribed in situations where the indemnitee's negligence was the sole cause of the loss or damage. These laws do not apply, however, to insurance companies that are in the business of taking the risks involved in protecting negligent people, nor do they apply to claims for economic loss.

Liability to third parties

Where a contractor constructs a building that will be sold or leased to a third party, does the contractor bear any potential responsibility to the third party? May the third party pursue a claim against the contractor despite the lack of contractual privity?

Whether a contractor bears responsibility to third parties for the work it performed depends upon the nature of the construction and the type of damages sustained by the third party, as well as the state in which the work is performed (as statutes and case law on this issue vary). Typically, in a commercial context, absent privity of contract, a third-party purchaser or lessee does not have any direct recourse against a contractor for claims of defective work, delays in turnover of the work and the like. However, there are some circumstances where the contractor still may be subject to liability in tort for a duty owed to the third party where improperly performed work results in personal injuries, wrongful death or property damage (excluding warranty-related claims). In residential construction, particularly condominium projects, while privity is also the standard requirement for a person to pursue a legal claim against a contractor, several states, especially Florida, Nevada and California, have enacted legislation that provides condominium owners with the right to bring a direct action against a contractor for claimed defective work that it performed in connection with the individual's dwelling. In those states, the right of condominium owners to sue contractors has become a mini-industry unto itself, as the plaintiff's attorneys specialising in representing condominium owners join with forensic engineers to pursue claims on many such projects. Consequently, the contractor (and its insurance carrier) is exposed to liability and significant litigation costs from someone with whom it never contracted or had any dealings.

Insurance

To what extent do available insurance products afford a contractor coverage for: damage to the property of third parties; injury to workers or third parties; delay damages; and damages due to environmental hazards. Does the local law limit contractors' liability for damages?

There are many different insurance products available to contractors and subcontractors in the US construction market. Collectively, these insurance products will cover most types of third-party liability exposure for personal injuries, property damage, environmental damage, and, in some cases, economic losses.

Many forms of insurance also are required by contract or by local laws, but, regardless, the most common insurances procured by contractors and design professionals include the following:

- employer liability insurance;
- errors and omissions insurance;
- comprehensive general liability insurance;
- pollution liability insurance;
- property insurance;
- builder's risk insurance;
- owners and contractors protective liability insurance;
- umbrella or excess liability insurance;
- worker's compensation insurance; and
- subcontractor default insurance (SDI).

There is no limit on the quantum of a contractor's liability to a third party, but there may be limits on the amount of coverage that an insurer is willing to provide in respect of a particular risk, such that the contractor is exposed to personal liability for damages sustained by a party in excess of the policy limits. For this reason, depending on the project, some contractors may procure umbrella or excess liability coverage to insure against the risk that the limits of a particular insurance policy are exceeded, but even these excess policies have limits that may conceivably be exceeded on a particular claim. Depending on the specific terms of the policy, insurance coverage may be available to cover delay damages sustained by a third party, but owing to coverage exclusions typically found in most liability policies, a contractor will usually not be able to insure against delay damages or liquidated damages it sustains as a result of its own actions or the actions of its subcontractors. The one exception may be in respect of SDI, which is specifically designed to insure the contractor against damages attributable to the default of one of its subcontractors.

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