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Strategies for Negotiating a Construction Contract

Real estate owners and construction contractors sue each other all the time. The reason is simple – construction rarely goes as planned. Given this reality, you as a real estate owner (whether a homeowner or a commercial property owner) need to get smart at the front-end of the construction, or else you might pay for litigation at the back-end.

Without further ado, here are five basic strategies for negotiating a construction contract.

1. **Detail Your Scope of Work.** The single most important provision in a construction contract is the scope of work. The owner should give a large amount of detail about the work to be done, including what the finished product should look like and what it should do, and anything else the owner believes is important. As an owner, you should sit down and list your most important objectives and concerns and then include these in the scope of work.

Just giving the contractor a set of plans is not enough. Owners must be careful in their plan review with the architect and the contractor to make sure they understand the work. Owners then must communicate the spirit of the plans to the contractor. As an owner, communicate your intent in simple English, detailing the goals you want achieved. For example, for an office building, “the HVAC shall be sufficient to allow all offices on the west (sunny) side of the building to be cooled to a temperature of 72 degrees even during the hottest days of the year at the hottest times of the day.”

2. **Understand Your Pricing Options.** You frequently can choose from several pricing options. The three most common are cost plus, stipulated sum, and a hybrid of cost plus with a guaranteed maximum (G-Max). Cost plus is the most favorable to the contractor, because it allows the contractor to be compensated for time and materials plus a percentage for overhead and profit. Stipulated sum is arguably the most even-handed, because it reflects what both parties believe is a reasonable price for the agreed scope at the time of contract. The most advantageous for the owner, however, is the hybrid. The hybrid gives the owner the benefit if a cost-efficient contractor completes the job for less than the G-Max, yet has the G-Max to give protection from cost overruns.

3. **Get a Retention.** Contractors juggle multiple jobs. There is a real risk that as the owner's job draws to a close, the contractor will focus on its new projects and their promise of new money. Here the contractor never gets around to your final, punch-list items. To keep the contractor's attention at the end of your job, hold back some portion (usually 10%) from the contractor's compensation. In this way, even on a relatively small \$500,000 job, the owner is still holding \$50,000 at the end. This keeps the contractor motivated to finish the job.

4. **Include an Attorney's Fees Clause.** If you sue your contractor and win, you want to recover your attorney's fees and costs (which can be significant). So add an attorney's fees clause to the contract. Note that the most commonly used form construction contract is the American Institute of Architects form, but this form does not contain an attorney's fees clause.

5. **Know Your Lender's Requirements.** If a construction lender is involved, ask the lender to recommend two or three contractors. By using a lender-recommended contractor, owners can leverage that relationship to get a contractor's most honest and responsible performance. Also, ask the lender up front for its required inclusions in the construction contract. This saves time when negotiating the contract, and even lets you use the good cop / bad cop negotiating strategy when negotiating with the contractor.

As always, these strategies are only the tip of the iceberg. You should hire an attorney for all important projects. Please feel free to call me if you want to talk more about this topic.

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