

May
June
2008

Construction

Accounting and Taxation



Enhanced Enforcement

OSHA Targets Construction

2007 AIA Contract Revisions: Focus on A201

Your Surety Reads Your Balance Sheet

How do you control profit



THE 2007 AIA CONTRACT REVISIONS: WHAT

A201, "General Conditions of the Contract for Construction," has been the industry gold standard for years, but the latest round of revisions has not been a rubber stamp.

CONTRACTORS NEED TO KNOW ABOUT A201

CHARLES (C.J.) SCHOENWETTER, ESQ. AND MICHAEL R. CAREY, ESQ.

In November of 2007, the American Institute of Architects ("AIA") released revisions to its form A201—1997, commonly referred to as the "General Conditions of the Contract for Construction." This revised agreement contains many changes that impact litigation strategies for contractors. Specifically, the AIA revised nine of its 14 articles and added a new article 15 abolishing mandatory arbitration provisions. For the first time in its over 100-year history, parties now can litigate disagreements arising out of the A201 as a matter of course.¹

The A201 was last revised in 1997 as part of the AIA's initiative to update its family of standard construction contracts every 10 years. Unlike previous revisions to the A201, however, the AIA's most recent changes are controversial. A number of organizations representing contractors and subcontractors have refused to endorse the revised A201. These organizations believe the recent revisions

do not provide the proper balance between the rights and risks of contractors and others involved in the building process. The concerns voiced by industry trade groups regarding the revised A201 will only materialize, if at all, after architects, contractors and owners start to use it and develop real world experience involving the dramatic changes it incorporates.

Rights to request the owner's financials reduced

Under the 2007 revisions, contractors may obtain the owner's financials if:

- The owner failed to make payments specified in the contract;
- Change orders, or other major work changes, materially alter the contracted price of the project; or
- The contractor identifies in writing a reasonable concern regarding the owner's ability to pay.

CHARLES (C.J.) SCHOENWETTER, ESQ. is a Partner at the law firm of Bowman and Brooke LLP in Minneapolis, Minnesota and has extensive experience litigating commercial and residential disputes on behalf of builders and contractors. He has published numerous articles and is a frequent lecturer on matters affecting builders. MICHAEL CAREY, ESQ. is an Associate at the same firm, focusing on complex commercial litigation including real estate and contract dispute matters. They may be contacted by telephone at (612) 339-8682. This column does not represent legal advice. If you have any questions about construction litigation matters, contact your attorney.

THE 2007 EDITION OF THE A201 MAY SIGNIFICANTLY DECREASE THE LEVERAGE A CONTRACTOR MAY EXERT ON SUBCONTRACTORS.

Previous versions of the A201 applied a lower standard that allowed contractors to request financials, and even stop work until the owner provided pertinent financial information. This change dramatically affects a contractor's ability to assess risk and the ability to recover against an owner in the event litigation becomes necessary. Consequently, contractors may decide to alter these provisions if the revised A201 is used as the basis for a contractual relationship with an owner.

Greater oversight by owner of subcontractor payments

Under the 2007 revisions, an owner may ask for written proof of payment to all subcontractors and suppliers. The A201 now requires that contractors must pay subcontractors "no later than seven days after receipt of payment from Owner." If contractors do not, or cannot, provide proof of payment to the owner within this time period, then the owner may contact subcontractors and suppliers directly. Under certain circumstances, the owner can issue joint checks directly to subcontractors and suppliers.

These changes effectively give owners more rights than they possessed previously. In some respects, they mirror common practice in the industry that already required signed lien waivers in order for payment to be received. However, many contractors view these changes as unnecessarily providing owners with a contractual right to interfere with their relationships with subcontractors. While owners view their construction projects with tunnel vision as a one-off project, contractors often view their relationship with subcontractors across a number of projects on which they both work. The 2007 edition of the A201 may significantly decrease the leverage a contractor may exert on subcontractors as a result of this change. To owners and subcontractors, however, these changes are a benefit.

Additional insured endorsement

The revised A201 removes the often ignored "Project Management Protective Liability Insurance" mandated under the

1997 edition of the contract. Contractors are now required to name the owner, the architect, and even the architect's consultants, as additional insureds under the contractor's general liability policy of insurance. This allocation of risk mirrors existing actual practice. Moreover, the additional insured endorsement is relatively inexpensive and is easily obtained.

The additional insureds are protected from liability arising out of the contractor's negligent acts or omissions occurring during the contractor's operations. This additional insured endorsement, though, does not require coverage for claims arising solely out of the acts or omissions of the owner or architect. Additionally, the "professional liability" exclusion in virtually all general liability policies means separate coverage for a design professional's negligent activities under their own insurance policies should still be available. From a litigation perspective, requiring an additional insured endorsement means the additional insureds will tender their defense to contractors in the event of litigation. Consequently, insurers will be defending more claims under their liability policies with contractors.

Expanded limitations period governed by state law

Under the revised A201, a party is limited by the applicable state law regarding the time period for asserting claims. The revised A201, however, also expressly provides a 10-year statute of repose. Previously, the A201 provided a date certain for triggering the start of the statute of limitations period, such as the date of substantial completion or final completion.

Statutes of limitations and repose for construction disputes vary greatly from state to state. Many states require that claims must be asserted within two to three years after *discovery* and impose a statute of repose pursuant to which claims cannot be asserted more than six to 10 years after a claim accrued. Because the revised A201 now relies on state law, where the statute of limitations may not begin to run until *discovery* of the alleged injury, and because many states apply a

statute of repose shorter than 10 years, contractors are potentially exposed to a larger time period during which claims may be asserted. This is a dramatic change that negatively affects contractors.

Architect no longer initial decision maker

The 2007 edition of the A201 allows parties to designate someone other than the architect as the Initial Decision Maker ("IDM") for disputes arising under the contract. Indeed, the title "IDM" is new to the A201 contract. Previously, all disputes between the owner and contractor were initially determined, as a matter of course, by the architect. Contractors expressed concern because they perceived architects as partial to the owner's position. Indeed, the owner typically hired the architect and paid the architect's invoices. Architects often felt pressured because of these awkward dynamics. The 2007 edition of the A201 resolved these issues by allowing parties to designate any third party neutral individual of their choosing to fulfill the role of IDM. Because the cost of retaining a third party may be substantial, the project architect is the default IDM if no other IDM is specified.

These changes give more control to the parties. Significantly, under the revised contract, decisions of the IDM need not be immediately appealed. Rather, the revised edition of the A201 contemplates circumstances where ongoing disputes may be preserved until after the conclusion of the construction project—unless one of the parties demands an earlier, final and binding resolution.

No more mandatory arbitration

The 2007 edition of the A201 allows parties to opt for litigation rather than arbitration. Specifically, the new form contains check boxes where the parties can select either litigation or arbitration. In any event, mediation is still required. If neither box is checked, the default position is litigation. This is considered a "win" for contractors. Although arbitration does have some benefits, many contractors prefer the security of the established,

detailed procedures and rules of evidence which are applicable in all litigation, but often lacking in arbitration.

Consolidation of arbitration actions

In order to make arbitration more efficient, the A201 now permits consolidation of arbitration between the owner and the contractor with arbitrations among other parties—including subcontractors and architects. However, consolidation is only available where: 1) the agreement to be arbitrated does not contain an anti-consolidation provision; 2) the proposed consolidated arbitrations contain common issues of fact or law; and 3) the proposed arbitrations use similar arbitration procedures.

These changes make it much easier for contractors and subcontractors to consolidate arbitration proceedings, and also results in greater efficiencies. On balance, this change is likely favorable for all parties to a dispute. Parties will not be subjected to multiple arbitration or litigation proceedings. Moreover, the possibility of inconsistent results obtained in multiple proceedings involving the same essential facts and issues is extinguished.

Conclusion

Changes to the standard A201 general conditions of the contract for construction present new challenges and opportunities. Many of the new provisions in the 2007 edition of the A201 dramatically change exposure to risk and liability for contractors and subcontractors alike. Although you may be familiar with the AIA standard contracts, it may be necessary to examine the A201—2007 form agreement quite carefully before incorporating it into your next contract. Understanding the terms of this revised contract increases your ability to avoid, shift and limit your exposure to legal liability. ■

NOTES

¹ For a general discussion of the AIA's new owner-architect agreement, see Friedlander, Mark C., "Changes and Controversial Issues in AIA's New Owner-Architect Agreement," 18 *Construction Accounting and Taxation*, No. 1, 22 (Jan./Feb. 2008).