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STANDARD FORM CONTRACTS “USERS BE WARY”

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I. INTRODUCTION

Risk Management is an important component in any construction contract. All construction contracts typically address the transfer and allocation of risk to the Owner and the assignment of responsibilities between the parties. Because of the importance of construction contracts, they should be drafted in a manner such that all parties are clear with respect to the risks and obligations of each party.

A few of the types of standardized contracts that are used in the construction industry are the following: CCDC-2 – Stipulated Price Contract (“CCDC-2”); CCDC-3 – Cost-Plus Contract; RAIC Contract for Architectural Services (Document 6) (“Document 6”), CCDC-14 – Design Build Contract (“CCDC-14”); and DBIA – Design Build Contract (“DBIA”).

Each standardized contract has varying degrees of risk allocation and therefore, must be reviewed and amended to suit the needs of the parties and specific project; what may be appropriate for one project is not necessarily appropriate for the next. Therefore, relying on standard form contracts without making amendments to specifically address each project can be dangerous and the allocation of risk may not be favorable to the parties.

Further, standardized contracts often have inherent problems or uncertainties. An example of this is GC 1.1.9 of CCDC-2 which sets out the priority of documents in the event that they are in conflict. The priorities provide that the Agreement and the Definitions take precedence over other documents including the Supplementary Conditions. This can become problematic where the Supplementary Conditions attempt to include amendments to the Agreement or the Definitions.

A further crucial point is that any changes to standard form contracts should be reviewed both by your lawyers and insurers as any changes may have profound consequences on both legal issues and on insurability issues.

In the ideal world, each party to a contract would agree to a perfectly balanced allocation of risk and responsibility. However, since this is not the case, when allocating risk parties should consider the fact that the Owner receives the greatest gain from the construction development and usually has the strongest legal and financial position and therefore, should bear the greatest risk.

In order to reallocate and transfer the responsibilities and risk parties should carefully consider the following types of clauses and amend them to create the optimum level of risk and obligation for each party:

- Environmental/Site Condition clauses;
- Indemnity clauses;
- Waivers of Claim clauses;
- Limitation or Exclusion of Liability clauses;
- Warranties clauses;
- Insurance clauses;
- Responsibilities of Parties clauses;
- Control of Project/Design clauses; and
- Fees/Delays clauses.

Although this paper primarily focuses on the CCDC-2 and Document 6, the issues that arise from these contracts can be applied and should be addressed in other standard form contracts. In addition, this paper will compare the CCDC-14 to its American equivalent, the DBIA.

II. INDEMNITY, LIMITATION OF LIABILITY AND WAIVER OF CLAIMS

1. Indemnity

An indemnity is a contractual undertaking by one party to reimburse the other party upon the occurrence of a foreseeable event or loss. It is only effective however, if the party giving the indemnity is able to bear the risk, and the best way to ensure this is to include a covenant requiring the indemnifier to maintain liability insurance. In addition, a prudent party should request that its principals, directors, officers, employees and if possible, its consultants and contractors also receive the benefit of the indemnity.

Another important issue with respect to an indemnity is the determination of whether the indemnity received survives the termination and completion of the construction contract. Ideally, for parties receiving an indemnity they will want to ensure the contract clearly provides that the indemnity will survive both the termination and the completion of the contract.

Pursuant to General Condition 12.2 Waiver of Claims in CCDC-2, the Contractor's obligation to indemnify the Owner and the Consultant is limited to 6 years from the date of "Substantial Performance of the Work", which is defined within the contract. In addition, the Contractor's obligation is limited to \$2,000,000 per occurrence before Substantial Performance and an aggregate amount of \$2,000,000 for all occurrences after Substantial Performance.

Unlike CCDC-2, Document 6 does not require the Architect to indemnify the Owner. In addition, the Owner's right to claim against the Architect is limited to \$250,000 unless otherwise specified. The 2002 version of the Document 6 gives further protection to architects. In particular, the Owner must indemnify the Architect from claims initiated by non-parties and arising out of a claim commenced by the Owner, where such claim exceeds \$250,000, or such amount mutually agreed to by the Owner and the Architect. Further, the new Document 6 gives the Architect the ability to rely upon a manufacturer's product warranties.

2. Exclusion/Limitation of Liability

If parties choose to use exclusion of liability clauses, they must ensure that these clauses are reached by consenting parties which have reasonably similar bargaining power. An exclusion clause will not likely be enforceable if inserted into a standard form contract by a dominant party, where the insertion of the clause was unconscionable in the circumstances. In addition, an exclusion clause must be clearly expressed, if the clause is vague, it may be argued that the intentions and/or goals of the parties were not the same. An exclusion clause must also be limited in its effect to the narrow meaning of the words employed by them. In order to rely on an exclusion clause, the exclusion clause must clearly cover the exact circumstances which arose.

Limitation of liability clauses are generally a more equitable allocation of risk and responsibility than exclusion of liability clauses, and as such they are less likely to be considered unconscionable or to be found void or invalid. The following are examples of limitation of liability clauses:

- Limiting the Consultant's liability to the amount of collectible insurance;
- Limiting the liability to the amount of or a multiple of the Consultant's fees; and
- Limiting the liability to a specified length of time, perhaps different than that specified by legislation.

3. Waiver of Claims

Waiver of claims effectively release claims by the Owner against the Contractor and/or the Consultant. This is essential as the Contractor and/or the Consultant want some certainty as to the time period of their liability and/or exposure.

General Condition 12.2.1 Waiver of Claims in CCDC-2 is an example of a waiver. It states that the Owner expressly waives and releases the Contractor from all claims against the Contractor including, without limitation, those that might arise from the negligence or breach of contract by the Contractor which may arise 6 years after the date of substantial performance of the work. Although this clause waives the Owner's right against the Contractor, it does not provide a

provision extending the 6 year limitation period in cases where there are latent defects that the Owner could not have been aware of.

III. HAZARDOUS SUBSTANCES – MOULD

In recent years, the issue of toxic mould has become a matter of some concern. Many standard form contracts such as CCDC-2 address hazardous or toxic substances but do not specifically address mould. In standard form contracts, the assumption is that since the Owner has the most to gain in the project, the Owner should carry the obligation and risk with respect to toxic and/or hazardous substances.

But, if the Contractor encounters toxic or hazardous substances, the Contractor has an obligation to immediately report it to the Consultant and the Owner in writing. In addition, the Contractor has to safeguard the people and the property which may be affected by the toxic and/or hazardous substances by containing the situation and suspending work if necessary. However, the Owner is still responsible for retaining an expert to investigate the substance and for paying the cost of disposing the toxic and/or hazardous substance. Under the current CCDC-2, what remains unclear is the responsibility of the Contractor, if the Contractor caused the mould.

1. General Condition regarding Mould in the New CCDC-2

In the February, 2003 Commentary on Proposed Changes to CCDC-2, a new General Condition was proposed that specifically addresses mould. This General Condition deals with mould in much the same way that the current CCDC-2 deals with toxic and hazardous substances and materials. The proposed General Condition is a good example of the allocation of risks and responsibilities between the parties. The Owner is responsible for retaining an expert to investigate the cause and nature of the mould and report the findings to the contractor. The Contractor is responsible for taking all necessary steps to prevent injury or death to the individual and to prevent any property damage. Finally, all parties who know of or suspect mould are required to provide written notices to all other parties with respect to the mould.

Under the proposed General Condition, if the mould was caused by the Contractor, then it must remedy the situation, repair any damage, pay the Owner's costs of investigation, and indemnify the Owner and the Consultant from claims arising from the mould outbreak. If the mould was not caused by the Contractor, then the Owner must remedy the situation, pay the Contractor for its costs of repairing the work, extend the work schedule if necessary, reimburse the Contractor for delays, and indemnify the Contractor and the Consultant from claims arising from the mould outbreak.

Unlike the current CCDC-2, under the proposed mould General Condition, the Consultant does not appear to have a role in dealing with the mould. Since mould is not addressed in the current CCDC-2, parties considering entering into the CCDC-2 should consider how the issue of mould is to be dealt with if a problem occurs.

2. Document 6

Architects, by contrast, have specifically addressed the need to limit their exposure regarding toxic and hazardous substances, including mould. In Document 6, the definition for “Toxic or Hazardous Substances or Materials” was amended to specifically include mould:

Toxic or Hazardous Substances or Materials means any solid, liquid, gaseous, thermal or electromagnetic irritant or contaminant, and includes, without limitation, pollutants, **moulds**, and hazardous and special wastes whether or not defined in any federal, provincial, territorial or municipal laws, statutes or regulations. **[emphasis added]**

IV. INSURANCE

Insurance policies are another area of concern when using standardized contracts. In reviewing insurance requirements, consider whether the Contractor should obtain insurance that designates the Owner and Consultant as “additional named insureds” rather than as “joint insureds”, as is the current requirement in CCDC-2.

A Contractor’s claims history will be impacted by the actions of the Consultant or Owner. As well, joint coverage may be eroded if more than one party is found at fault on a project. And aggregate coverage can be eroded by claims against the Contractor on other projects.

In addition to coverage obtained by the Contractor, the Owner and/or the Consultant should consider obtaining their own liability policies, particularly a wrap-up liability policy.

As a general principle, all parties should carefully review the details of their insurance coverage, particularly deductibles, coverage limits and specific exclusions such as mould.

V. EXTRA WORK AND CHANGE ORDERS

1. CCDC-2

Another area of concern in using standard form contracts is the treatment of extra work or change orders. Under CCDC-2, a change directive is a written instruction prepared by the Consultant and signed by the Owner directing a change in the work within the general scope of the contract.

Although not explicitly stated, a change directive does not need prior approval between the Owner and the Contractor with respect to an adjustment to the time and contract price.

By contrast, a change order is a written amendment to the contract prepared by the Consultant, which requires the signature to and agreement of both the Owner and the Contractor to the change in the work, the method or amount of adjustment to the contract price and the extent of the adjustment to the contract schedule if any.

Although the terms “change order” and “change directive” are defined within CCDC-2, there are questions relating to the use of change directives which are not addressed in CCDC-2; examples include:

- Whether a change directive can be used to direct a change in the contract schedule only;
- The timing under which the Contractor is obligated to disclose records and accounting information regarding a change directive to either the Consultant or the Owner; and
- What happens if a change directive is used and the Contractor does not exercise appropriate care and diligence in completing the change directive?

2. Document 6

In contrast to CCDC-2, the provisions in Document 6 that deal with extra work are arguably more straightforward. Under Document 6, if the scope of the project or the Architect’s services change, then fees are adjusted accordingly. If and to the extent that time initially established for the contract is exceeded or extended (through no fault of the Architect), the fees required for such extended period of the contract administration will be adjusted and computed as set out in the contract.

VI. PROGRESS PAYMENTS, SUBSTANTIAL PERFORMANCE AND DISPUTE RESOLUTION

1. Progress Payments

A further revision which should be considered when using CCDC-2 is the time period for the Consultant to provide payment certification and for the Owner to make payment. Under the current CCDC-2, General Condition 5.3 Progress Payment requires that the Consultant certify the Contractor’s application for progress payment within 10 days of receipt of the application and the Owner is required to make payment within 5 days of receiving the Consultant’s certificate for payment from the Consultant. This time period of 5 days can be unrealistic and often results in the Owner amending the contract to extend the payment time period.

It is anticipated that in the new version of CCDC-2 progress payments will require the Consultant to provide immediate notice to the Owner of the Contractor's application and allow the Owner 20 calendar days or to the end of the month, whichever is later, to make payment to the Contractor.

2. Substantial Performance of the Work

In comparing General Condition 5.4.2 of CCDC-2, which deals with substantial performance, with General Condition 5.7.2 of CCDC-2, which deals with final payment, it is unclear how long the Consultant has to review and verify substantial performance payments and final payments. General Condition 5.4.2 states that the Consultant will begin a review within 10 days of receiving the Contractor's list and application and will notify the Contractor of the Consultant's decision within 7 days of completing the review. However, CCDC-2 does not stipulate how long the Consultant has to carry out the review.

3. Dispute Resolution

A further concern in using CCDC-2 is that one party can unilaterally decide to proceed with arbitration. In a dispute under General Condition 8.2.6 of CCDC-2, after the termination of mediated negotiations, either party may give notice to refer the dispute to arbitration.

By contrast, General Condition 7 *Dispute Resolution* in Document 6 states that both parties must agree to refer a dispute to mediation or arbitration. Contractual arbitration may force a dispute to be resolved in multiple forums as disputes often involve more than the two contracting parties.

VII. CCDC-14 DESIGN BUILD CONTRACT VERSUS DBIA FORMS

In recent years, design build contracts have become more common and CCDC-14 has become widely used in Canada. CCDC-14 is largely based upon CCDC-2 and consequently, has inherited many of CCDC-2's characteristics.

In CCDC-14, the Consultant is a contractor of the Design Builder. Therefore, not only is the Consultant responsible for drawing up the design of the project, the Consultant is also responsible for reviewing the progress of the construction and ensuring that all laws, regulations, bylaws and codes are followed.

In addition, the Consultant determines the date of substantial performance and is responsible for issuing a certificate of substantial performance. The Consultant also verifies the Design Builder's application for final payment and reviews defects and/or deficiencies. Although the Design Builder hires the Consultant, the Consultant plays a large role in monitoring and furthering the interests of the Owner.

Although CCDC-14 is widely used, it has not been endorsed by the Association of Consulting Engineers of Canada (“ACEC”). The ACEC’s position is that the use of CCDC-14 will lead to an “inevitable conflict” between the Consultant and the Owner. According to the ACEC, the Owner should retain a separate design professional to look after its specific interest as the Consultant is retained by the Design Builder.

An alternative design build contract is the design build contract published by the Design Build Institute of America (“DBIA”), which has been endorsed by the ACEC. The DBIA’s version of the design building contract avoids the “inevitable conflict” by reducing the role of the Consultant. In the DBIA standard form contract, the Consultant’s role is limited to furnishing a design as required by the contract. There is no contractual relationship between the Owner and the Consultant. The Owner and the Design Builder jointly inspect the work to determine the date of substantial completion and the Consultant plays no part in the approval process.

The issues addressed in this paper highlight some of the key problem areas which parties should consider when using a standard form contract. The interests of the various parties will vary greatly from project to project. Hence, when using standard form contracts some level of modification should be considered to optimally balance the risks and obligations of the involved parties.