Nutter uncommon law

INSIGHTS

"All of the parties involved on a project should agree on the following: 1) price and method of compensation; 2) the scope of the project; and 3) timing for completion."

3 Commercial Construction Issues to Hammer Out Before the Shovel Hits the Ground

Q: WHAT ARE THE THREE ISSUES THAT ALL PARTIES NEED TO AGREE ON BEFORE EMBARKING ON A COMMERCIAL CONSTRUCTION PROJECT?

CHRISTOPHER W. PAPAVASILIOU: Often times, construction projects need to move quickly and there is little time to get a construction contract in place. But, you can do yourself a favor and avoid future disputes by making sure you and your contractor are on the same page on the following: 1) price and method of compensation; 2) the scope of the project; and 3) timing for completion. Even if a project is moving quickly on bare-bones AIA form documents (i.e., form documents created by the American Institute of Architects), those three items will let everyone know who's doing what by when and what the costs will be.

Q: COULD YOU EXPLAIN THE DIFFERENCE BETWEEN LUMP SUM COMPENSATION AND GUARANTEED MAXIMUM PRICE COMPENSATION?

CWP: Guaranteed Maximum Price and Lump Sum contracts share some similarities in that they limit the exposure of the owner for cost overruns, but they differ substantially in practice.

A Guaranteed Maximum Price contract (also known as a GMP Contract) has four main components: 1) The "Cost of the Work," which is the actual cost to complete the work. There is a give-and-take on what is excluded, i.e., bonuses, main office salaries, and other items; 2) The "Fee," which is generally a percentage of the Cost of the Work; 3) The "Guaranteed Maximum Price," which is the maximum amount that the contractor will charge; and 4) "Savings," in the event of the Cost of the Work being less than the Guaranteed Maximum Price. Savings are allocated between the owner and contractor on a pre-determined percentage breakdown. Because compensation is based on the contractor's actual costs incurred, a Guaranteed Maximum Price contract requires that the owner review requisitions in detail, including invoices, and is administratively more time consuming for the owner.

On the other hand, a Lump Sum contract (also known as a Stipulated Sum contract) is easier to administer. It boils down to the contractor saying "I'll build the project for $X." The owner knows how much the project will cost, and all cost savings inure to the contractor. Lump Sum contracts are often favored due to their simplicity.

Keep in mind that the Guaranteed Maximum Price and Lump Sum amount will increase for change orders.

Q: HOW CAN THE OWNER ENSURE THAT THE PROJECT IS COMPLETED IN A TIMELY MANNER?

CWP: Approximately 95% of the time, the construction contract will be based on standard AIA documents. These forms cover the basics, but are a little light on the owner's recourse if the contractor is late in timely completion. Two options on how to handle timely completion are incentives/cost savings and liquidated damages. Cost savings under a Guaranteed Maximum Price contract often get divvied up between the owner and construction manager. One way to incent the contractor to achieve early completion is to alter the percentage rate of savings going to the contractor based on when substantial completion is reached. Usually, liquidated damages are assessed on a day-for-day basis.

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