LESSON ONE - CONTRUCTION CONTRACT ADMINISTRATION

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GENERAL CONCEPTS

Introduction

Construction contract administration is a term that encompasses a wide range of services performed by an architect after completion of the bidding or negotiation phase, and extending up to and sometimes beyond conclusion of the construction of the project. On occasion, the terms "supervision" and "inspection" are used to describe the construction phase services of the architect. This usage, however, is incorrect and should be avoided because of the liability problems that can ensue. More on this later, but it is important to recognize at the outset that there is no single word in the English language to describe all the services customarily performed by an architect during the construction phase.

The single best source of information about an architect's customary construction phase services -- construction contract administration -- is found in the standard AIA Owner-Architect Agreement form (AIA Document B141). Paragraph 2.6 (1987 Edition) describes in detail what is expected of an architect during the construction phase. This description of services is paralleled in the standard AIA General Conditions of the Contract for Construction (AIA Document A201). Throughout this lesson, repeated references will be made to these two AIA Documents (B141 and A201, see Documents Package).

In 1987, the AIA issued new editions of a number of documents, including B141 and A201. The documents have been revised and substantially reorganized from earlier versions, and this course has been updated to reflect these changes. For this course, for the licensing examination and throughout an architect's professional career, familiarity with the provisions in these two standard AIA documents is a fundamental requirement. As a minimum, the two contract forms should be "read through" so that the material in this course can be studied in context. Much of what will be covered in this course will explain the provisions in the AIA contract documents.

Principles of Agency Law

An agent is defined as someone who is authorized to act on behalf of another party (the principal). Both persons and corporations can act as agents for other persons or corporations (who may be principals). The authority of an agent normally is established by an agreement between the parties, but it can be determined by the agent's conduct and implied conditions.

During the construction phase, an architect normally performs construction contract administration as the owner's agent. In order to avoid liability problems, the agreement between the architect and the owner should spell out the scope of the architect's "agency" and establish that the architect is authorized to act on behalf of the owner only to the extent set forth in the contract. In the absence of a written contract, the scope of the architect's agency will be implied or determined by general principles of law. When the architect is acting as an agent for the owner, it is important that the

owner's identity be disclosed, because an agent can be held personally liable if he acts on behalf of an undisclosed principal. This can have direct implications in regard to who is responsible for paying for the construction work, among other things.

Standard Contract Requirements

The scope of the architect's role as the owner's agent is established by subparagraph 2.6.2 in AIA Document B141 (1987):

"The Architect shall provide administration of the Contract for Construction as set forth below and in the edition of AIA Document A201, General Conditions of the Contract for Construction, current as of the date of this Agreement, unless otherwise provided in this Agreement."

Note that this provision about the scope of the architect's construction contract administration services is in the Owner-Architect agreement, but it makes a direct reference to the General Conditions, which is part of the Owner-Contractor agreement. The reason for this is both simple and important: the Owner-Architect agreement establishes the scope of the architect's authority to act as the owner's agent, and the contractor is informed about this authority by parallel provisions in the General Conditions of the contract for construction. (The contractor would not normally see the Owner-Architect agreement because he is not a party to it.) It would make little sense for the architect to be authorized to act as the owner's agent during construction if the contractor were not informed about the architect's role and thus would be unaware that the architect could act on behalf of the owner in this manner. As you can see, what is generally recognized as customary practice in the construction industry (i.e., the architect representing the owner's interests during construction) is clearly defined in the legal documents between the parties.

The architect must know and understand the contract terms that establish the scope of his or her agency. Because he or she is the owner's representative, the architect must be careful not to act in a way that either causes problems for the owner or creates a professional liability exposure for himself. For example, the contract normally gives the architect the power to reject work that does not conform to the requirements of the contract documents (B141, subparagraph 2.6.11, and A201, subparagraph 4.2.6), but the architect normally would not have power to stop the work without independent written authorization from the owner. Serious consequences (such as delay claims and the potential exposure to claims by workers who get injured during the course of construction) can flow from a right to stop the work. This has led to the elimination of the contract language that formerly gave the architect the right to stop the work. Only the owner can order the work to be stopped.

In addition, the construction contract makes the contractor responsible for construction means, methods, techniques, sequences, procedures and for safety precautions in carrying out the work. Therefore, the architect, as the owner's agent or

otherwise, should not involve himself or herself in how the contractor performs this work -- only whether the work performed meets the requirements of the contract documents so that the owner is getting what he is paying for. The architect also should avoid direct contact with subcontractors and suppliers, except in strict accordance with the provisions of the contract documents. (See, for example, A201, subparagraph 9.6.3, which permits the architect to furnish subcontractors with information on the percentages of completion or the amounts of payment applied for by the contractor.) If the architect deals with subcontractors outside of permissible contract bounds, he or she can become liable for interfering with the contractor's contractual relationships with subcontractors.

Professional Liability Coverage

Professional liability insurance is insurance which protects an architect against claims which may arise out of his or her negligent acts, errors or omissions during the performance of professional services. It sometimes is called "errors and omissions" insurance or malpractice insurance. Although this insurance is usually very costly, most established firms carry it. Sophisticated clients, such as corporations and some government agencies, often require, as a condition of the Owner-Architect Agreement, that the architect have professional liability insurance.

As with any insurance policy, the professional liability policy contains exclusions to limit certain types of claims for which the insurance does not apply. Some exclusions are quite broad, such as the exclusion for claims arising out of any express warranties or guarantees that the architect may have agreed to. Other exclusions apply to specific aspects of rendering services, such as claims arising out of cost estimates being exceeded.

It is important to recognize that professional liability insurance covers the architect's liability for professional negligence. Negligence is defined as a failure to meet the ordinary standard of care expected of an architect under the same or similar circumstances as those associated with actual allegations of negligence in a specific case. Before an architect can be found liable for negligence, a plaintiff (the person bringing the claim) must allege and prove that there was a legal duty owed by the architect, the architect breached that duty (the architect did something he or she should not have done or failed to do something he was supposed to have done), and the breach of the duty was the proximate cause of (was somehow directly related to) actual injury or damage suffered by the person bringing the claim. All of these factors must be present before an architect can be found liable for negligence. Because an architect's professional liability is based on the law of negligence, professional liability insurance policies do not provide coverage for intentionally wrongful acts.

During a trial, the professional standard of care is determined by the testimony of expert witnesses -- other architects -- who are knowledgeable about what is ordinarily expected of an architect under the circumstances. The testimony of

expert witnesses plays a significant role in determining whether liability is imposed on an architect for damages or injuries that occur during the course of a project.

GENERAL LEGAL PRINCIPLES

Liens

A mechanic's lien is a legal claim against someone's property. Liens are authorized by statutes in every state and the District of Columbia to protect people who expend labor or install materials to improve someone else's property. Because the labor or materials cannot be repossessed once they are incorporated into the property, the right to a lien protects the worker's right to payment. If the recipient of the labor or materials fails to pay for them, his property can be attached by a lien to ensure that there will be collateral for the debt. That is, the property itself becomes the security for the money owed if it is not otherwise paid, and if the claimant is forced to go to court to collect. After a mechanic's lien is filed, the claimant still must file a lawsuit to prove his right to payment and to get a court order to foreclose on the property.

Mechanic's liens are carefully defined by statute, and all statutory requirements must be complied with or the lien may be invalidated. Lien statutes customarily require that liens be filed within 30 to 90 days (depending on the jurisdiction) after the last work is performed or materials are installed. Some jurisdictions require subcontractors to file a notice of lien before they can actually file a lien. In all jurisdictions, general contractors have lien rights, and this is normally true with subcontractors, as well. Whether or not lien rights extend to sub-subcontractors or material suppliers depends on the lien laws of the jurisdiction in which the project is located. The law differs from state to state about architect's lien rights. In a few states, architects have absolutely no right to a lien for any architectural services. In others, the project must proceed into construction before an architect has lien rights. And, in other states, an architect can assert a lien even if only design services have been performed, if he or she is not paid. As noted, the lien laws vary considerably from state to state, and they must be checked carefully before a lien is filed.

In order to protect the owner from liens if a contractor fails to pay his subcontractors or material suppliers, the standard AIA contract documents set up several layers of protection. If liens are actually filed, or if the architect receives information that indicates that liens may be filed, this is a very serious matter, and the owner must get his attorney involved. After all, it is the owner's property against which the lien claimants are asserting their claims. However, the architect must be familiar with lien-related concepts, because both the owner and his attorney often will look to the architect for technical assistance in sorting out the situation.

The first level of protection for the owner to guard himself against liens involves the retainage. By withholding (retaining) a small percentage of the money owed to the

contractor, as the construction progresses, the owner will be in possession of funds to pay for labor or materials if the contractor fails to make payment; retainage also can be used to pay for the correction of work performed improperly. Obviously, if the work has been performed properly and all bills have been paid, the retainage must be paid to the contractor at the end of the construction phase. If the contract calls for retainage, however, the retainage should never be reduced or released without the written permission of the surety company that issued the performance bond for the contractor. This will be covered later in detail in the discussion on Bonds and Insurance. Retainage is provided for in the standard AIA Owner-Contractor Agreement, AIA Document A101, Article 5 (see Documents Package). In addition, subparagraph 9.5.1 in the AIA General Conditions (A201) states in part:

"The Architect may decide not to certify payment and may withhold a Certificate for Payment in whole or in part, to the extent reasonably necessary to protect the Owner because of:

.2 third party claims filed or reasonable evidence indicating probable filing of such claims;
.3 failure of the Contractor to make payments properly to Subcontractors or for labor, materials or equipment;..."

Therefore, if the architect has information that the contractor is not paying his bills, he can require adjustments in the contractor's Application for Payment to hold back funds to protect the owner.

Another level of protection for the owner is to require the contractor to provide a Labor and Material Payment Bond. This is a bond that guarantees payment for labor and materials if the contractor fails to pay for them. This will be covered in detail later in this lesson.

A further level of protection is to require the contractor to submit an affidavit and releases of lien before he is entitled to receive final payment from the owner. This is provided for in the AIA General Conditions (A201) in paragraph 9.10.2 which states:

"Neither final payment nor any remaining retained percentage shall become due until the Contractor submits to the Architect (1) an affidavit that payrolls, bills for materials and equipment, and other indebtedness connected with the Work for which the Owner or the Owner's property might be responsible or encumbered (less amounts withheld by Owner), have been paid or otherwise satisfied, (2) a certificate evidencing that insurance required by the Contract Documents to remain in force after final payment is currently in effect and will not be canceled or allowed to expire until at least 30 days' prior written notice has been given to the Owner, (3) a written statement that the Contractor knows of no substantial reason that the insurance will not be renewable to cover the period required by the Contract Documents, (4) consent of surety, if any, to final payment, and (5) if required by the Owner, other data establishing payment or satisfaction of obligations, such as receipts, releases and waivers of liens, claims, security interests or encumbrances

arising out of the Contract, to the extent and in such form as may be designated by the Owner. If a Subcontractor refuses to furnish a release or waiver required by the Owner, the Contractor may furnish a bond satisfactory to the Owner to indemnify the Owner against such lien. If such lien remains unsatisfied after payments are made, the Contractor shall refund to the Owner all moneys that the Owner may be compelled to pay in discharging such lien, including all costs and reasonable attorneys' fees."

In order to facilitate receipt of the contractor's affidavit and release of liens, the contractor can submit properly completed copies of AIA Document G706, Contractor's Affidavit of Payment of Debts and Claims and AIA Document G706A, Contractor's Affidavit of Release of Liens. (See Documents Package.) These documents include a statement by the contractor, sworn to before a notary public, that all subcontractors, material suppliers and others have been paid. Any exceptions must be noted on the form. In addition, the form requires the contractor to attach separate releases or waivers of liens from subcontractors and material or equipment suppliers to the extent required by the owner. There is no AIA form for the release of lien required from subcontractors, but most contractors have developed their own forms. In general, they require the subcontractor or supplier to state that he has been paid for all labor and materials for the project and that he releases all rights to assert a lien against the property. If the contractor is unable to secure a release of lien from all subcontractors or material or equipment suppliers, he can provide a lien bond to protect the owner from loss in the event a lien is filed.

All of the above procedures -- retainage, bonds, and releases of lien -- are designed to protect the owner for having to pay twice for labor or materials. If the owner pays the contractor, but the contractor fails to pay his subcontractors or suppliers, the latter parties can assert a lien against the owner's property. If they are successful in proving their claim of nonpayment, the owner must either pay them directly, or else risk losing his property. Because mechanic's liens are such serious business, the law and the standard AIA contract documents provide important protections that must be understood by the architect as part of his construction phase services.

Arbitration

The architect's special role in the arbitration process will be covered later in this lesson, but some general comments are in order at this point. Arbitration is widely used in the construction industry as a dispute resolution mechanism. Examples of arbitration clauses can be found in standard AIA documents dating back to the late 19th Century. Today, standard construction industry documents typically require mandatory, binding aribtration of any disputes that arise between the parties to the contract. The arbitration proceedings usually are conducted under the auspices of the American Arbitration Association (AAA), but the parties can agree to non-AAA arbitration. The AAA has developed a set of Construction Industry Arbitration Rules to govern the arbitration

American Arbitration Association

CONSTRUCTION INDUSTRY ARBITRATION RULES

DEMAND FOR ARBITRATION

DATE: March 15, 1989

TO: (Name) Empire Trust Company, Inc.
(of party upon whom the Demand is made)

(Address) 255 Royal Way

(City and State) Kingsville, Maine

(Telephone) (606) 725-3282

Named claimant, a party to an arbitration agreement contained in a written contract,

dated January 2, 1988 providing for arbitration under the Construction Industry Arbitration Rules, hereby demands arbitration thereunder.

(attach arbitration clause or quote hereunder)

Paragraph 4.3 The General Conditions of the Contract as referenced in Article 9 of the Owner-Contractor Agreement.

NATURE OF DISPUTE: Under the contract dated January 2, 1988, Jones Brothers Construction Co., Inc. demands payment of $45,000, such sum representing final payment due on construction contract with Empire Trust Company, Inc. Empire Trust Company contests this demand, claiming that construction of its building is not complete by virtue of several unresolved problems.

CLAIM OR RELIEF SOUGHT: (amount, if any)

$45,000 plus $2,700 interest at a rate of 12 percent per annum for a period of six months.

Please indicate industry category for each party.

Claimant:

☐ Owner ☐ Architect ☐ Engineer ☒ Contractor ☐ Subcontractor. Specify

Other

Respondent:

☒ Owner ☐ Architect ☐ Engineer ☐ Contractor ☐ Subcontractor. Specify

Other

HEARING LOCALE REQUESTED: Kingsville, Maine
(City and State)

You are hereby notified that copies of our Arbitration Agreement and of this Demand are being filed with the American Arbitration Association at its Bangor, Maine Regional Office, with the request that it commence the administration of the arbitration. Under Section 7 of the Arbitration Rules, you may file an answering statement within seven days after notice from the Administrator.

Signed Gerald Ferrari Title Attorney
(May be Signed by Attorney)

Name of Claimant	Jones Brothers Construction Co.
Address (to be used in connection with this case)	6506 Broadway
City and State	Bangor, Maine Zip Code 32323
Telephone	(606) 925-3663
Name of Attorney	Gerald Ferrari
Address	65 Elink Street
City & State	Bangor, Maine Zip Code 32319
Telephone	(606) 911-8274

To institute proceedings, please send three copies of this Demand and the arbitration agreement, with the filing fee, as provided in Section 48 of the Rules, to the AAA. Send original Demand to Respondent.

FORM CDCR-1987

process. (See Page 1-9 for a sample Demand for Arbitration form.)

In all but a few states, contract clauses requiring arbitration of future disputes are valid and binding. In a few states, arbitration clauses are not binding in regard to future disputes, but even in those states, the parties can agree to binding arbitration after a dispute arises. The courts generally take a very liberal attitude toward arbitration and normally will require matters to be arbitrated if there is any basis for doing so. That basis is the existence of an agreement between the parties to arbitrate their disputes. No one can be compelled to arbitrate if he has not agreed to arbitration, but once there is an agreement to arbitrate, it is very difficult to avoid arbitration.

The standard AIA contract documents contain a broad arbitration clause calling for arbitration of "all disputes." These clauses can be found in Article 7 of the AIA Owner-Architect Agreement (B141) and in Paragraph 4.5 of the AIA General Conditions (A201). Other form contracts contain similar arbitration clauses. The AIA arbitration clauses attempt to limit the arbitration proceedings to the parties to the specific contract. The clause specifically prohibits consolidation or joinder of multiple arbitration proceedings involving other parties, even on the same project. In other words, an arbitration proceeding between the owner and the architect cannot be consolidated with an arbitration proceeding involving the owner and the contractor, unless all parties have consented to consolidated arbitration proceedings. This clause in the AIA contracts is fairly recent, and there are few court decisions interpreting it. To date, the courts generally have upheld the restriction on involuntary consolidation; in a few states, however, statutes have been enacted to give courts the power to order consolidated arbitration proceedings even when prohibited by contract.

The rationale behind the clause prohibiting consolidation is that arbitration is a voluntary agreement only between the two parties to the contract, and they should not be forced to arbitrate with anyone else. On the other hand, it can be argued that separate arbitration proceedings involving common parties and facts would be economically wasteful and could result in inconsistent findings. For the architect, however, the danger of consolidated arbitration stems from the nature of the legal duties of a professional versus the contractual obligations of a contractor. These legal nuances can be lost on an arbitrator who may not be an attorney, and the architect could be held liable for damages for which he otherwise would not be legally liable.

In arbitration, the arbitrator hears the arguments and evidence presented by each party, and he then makes a decision (an award) based on the facts and the law as he understands them. There is no requirement that the arbitrator give any reasons for his decision, and the decision is final and binding and cannot be appealed (except on some very narrow grounds such as fraud or collusion between the arbitrator and a party). Under the standard arbitration clause, the arbitration is not a condition precedent to going to court. Once the arbitration has been held, the case

normally is over, regardless of the outcome. The standard arbitration clause states that the award shall be final, and judgment may be entered upon it in any court having jurisdiction.

Even though the standard AIA documents call for mandatory arbitration, there is no general legal requirement that the parties must agree to arbitration. It is not uncommon in non-AIA contracts for the arbitration clause to be eliminated, and the parties can always agree not to arbitrate even after signing a contract containing an arbitration clause (but both parties must agree, in this case). If there is no agreement to arbitrate, the dispute or claim must be dealt with in court, as with any other legal matter.

There is no way to determine beforehand whether arbitration or litigation (going to court) is preferable. The AIA and other construction industry organizations have made a policy decision that arbitration is to be preferred, and they have included arbitration clauses in their standard contract documents. For each supposed advantage of arbitration there can be arguments to the contrary. Nonetheless, arbitration is cited as being advantageous because it often can be scheduled more quickly than a trial, it can be less costly, the matter can be heard by an arbitrator who has expertise in the construction industry, and it is private. This last factor is a particular benefit to architects who normally are concerned about their professional reputations and do not relish being involved in court proceedings that are a matter of public record.

BONDS AND INSURANCE

General

Although bonds and insurance are often discussed together, and both are provided by the insurance industry, there are fundamental differences between the two. A bond is essentially a guarantee -- the bonding company's role being similar to that of a co-signer on a bank loan. The surety (the party that issues the bond) guarantees that the principal (the contractor) will perform certain acts to be undertaken for the benefit of the obligee (the owner). There is no expectation of loss with a bond, as the owner, contractor and surety all believe the contractor is capable of properly performing the work. If they did not, presumably, the owner would not hire the contractor, the contractor would not agree to undertake the work, and the surety would not agree to issue the bond. Despite this confidence, bonds are usually required, <u>just in case</u>, because of the significant financial risk associated with most construction projects.

Insurance, on the other hand, anticipates the possibility of loss and is written with the expectation that events will occur to cause a loss. However, it is not known which individual in a group of insureds will suffer the loss. (The only exception to this occurs with life insurance where it is known that all insureds will eventually suffer the loss -- i.e., die; when this will occur, however, is not known.) By pooling relatively small amounts of money (the premiums), a large sum can be aggregated to pay or compensate those members of the group of insureds who suffer a

loss. If you think in terms of auto or home insurance, you should be able to see readily how this concept operates. The small premium paid by all car or home owners enables the insurance company to pay out large sums to the relatively few unfortunate individuals who are in car accidents or whose homes burn down or are burglarized. Now we will discuss specific forms of construction bonds and insurance.

Bid Bonds

A bid bond is a bond furnished by a bidder (contractor), as part of his bid submission, to guarantee two things:

1. That the bidder will, in fact, enter into a contract with the owner at the price and on the terms stated in his bid; and

2. That the bidder will provide a performance and labor and material payment bond to guarantee that the work will be properly carried out and paid for.

If the bidder fails to do these two things, the surety or bonding company is liable for any extra costs, up to the penal amount of the bond, incurred by the owner in good faith in order to enter into a contract with another contractor. (See AIA Bid Bond, A310, in Documents Package.)

On occasion, the bid documents may permit bidders to submit a certified check in some stated amount (possibly five percent of the bid) or a set dollar amount in lieu of a bid bond. The principle remains the same: if the selected bidder fails to enter into the contract, the owner can use the bid security to pay for any increased costs or other damages suffered by having to contract with another party.

Performance and Labor and Material Payment Bonds

The performance bond and the labor and material payment bond guarantee precisely what their titles indicate -- performance of the work and payment for labor and materials. These bonds are discussed together because they are often written on a combined form. (See AIA Document A311, Performance Bond and Labor and Material Payment Bond, and A312, Performance Bond and Payment Bond, in Documents Package.)

A312 is a more recent performance bond and payment bond form which combines two separate bonds into one form. It is not a single combined performance and payment bond, however. The 1970 edition of A311 continues to be published for use because it complies with certain federal and state laws (called "Miller Acts") which require the use of bonds on public works in lieu of allowing the contractor mechanic's lien rights.

The amount of the performance bond normally is 100 percent of the contract amount. The issuance of a 100 percent bond indicates that the contractor's surety company believes the contractor can carry out the work. If the contractor requests a lower bond amount, it could suggest that he has "capacity" problems -- his surety company may not be willing to write a bond for him in excess of a certain limit (his capacity) because the surety does not believe the contractor has the capability to perform that volume of work, either on its

own or in combination with other projects under contract.

On occasion, an owner may decide to eliminate the requirement for a performance bond because the owner believes the contractor has sufficient strength to carry out the work, and the owner is not concerned that the contractor will default on the contract or go out of business. This can result in a savings of between one and one and a half percent of the contract price. Nonetheless, the decision to eliminate the requirement for a performance bond should be made by the owner only after consultation with his attorney and other advisors. The architect might be asked his opinion about the contractor's stability, and for a recommendation in this regard, but any recommendation should include an alert to the owner about the risk associated with not having a bond, no matter how stable and capable the contractor may appear to be.

In the event of a default by the contractor, the performance bond requires the surety company to either 1) complete the contract in accordance with its terms and conditions, or 2) obtain bids to enable another contractor, under contract to either the surety or the owner, to complete the contract in accordance with its terms and conditions. The surety's financial liability extends to the penal amount on the face of the bond. Under the standard AIA bond form, any suit to enforce the bond must be brought within two years from the date on which final payment under the contract falls due.

Not all contractors and their sureties use the standard AIA bond forms, so the owner's attorney and insurance advisors should review the actual bond forms submitted by the contractor to determine what notices may be required (about extensions of time or change orders, for example) and the procedures in the event of a default. Architects' professional liability insurance excludes coverage for claims arising out of giving or failing to give advice about insurance and bonds, so architects can avoid exposing themselves to this uninsured liability by not attempting to interpret bond terminology for their clients.

The labor and material payment bond, as indicated above, protects the owner against claims by subcontractors and suppliers who are not paid by the contractor. This bond gives those parties the direct right to sue on the bond in order to collect payment from the surety. The owner has no liability for any costs or expenses associated with any such suit. The AIA Labor and Material Payment Bond (A311) or Payment Bond (A312) extends protection to parties having a direct contract with the contractor, to parties having a contract with a subcontractor of the contractor, and to water, gas, power, light, heat, oil, gasoline, telephone service and equipment rental directly applicable to the contract. There is no requirement that a claimant must file a lien before attempting to collect payment from the surety company. In fact, suing on the bond is a clear alternative to filing a lien in an attempt to collect from the owner.

With both the performance bond and the labor and material payment bond, the retainage, if any, held by the owner can be used by the surety to reduce its financial losses. In the event of a default or failure of

payment by the contractor, the owner does not get the remainder of the work "for free." The owner still must pay the contract amount; the surety only pays for any excess costs caused by the contractor's default, up to the penal amount of the bond. Because the retainage is viewed as the surety's money in the event of a default, the retainage should never be reduced or released without the surety's written permission. Even if things are going smoothly on a project, and a reduction or release of retainage seems in order, the contractor could be in trouble on other projects. In that case, the surety probably would want to keep a close watch on all of the contractor's finances. To facilitate getting the surety's permission for a reduction or release of retainage, AIA has developed two forms -- Consent of Surety to Reduction in or Partial Release of Retainage, AIA Document G707A, and Consent of Surety Company to Final Payment, AIA Document G707. (See Documents Package.) These two forms alert the surety that retain ages will be released upon the surety's consent and that the surety's obligations remain intact even though this money will be paid to the contractor. If the surety has any objections to this, it can refuse to execute the documents. In that case, the retainage should not be reduced or released. The consent of the surety to final payment is a contract condition contained in subparagraph 9.10.2 of the AIA General Conditions (A201).

Contractor's Insurance

Construction contracts normally require the contractor to carry various types of insurance to protect against risks or liabilities associated with the construction of a project. This insurance is important because it can protect the owner and architect, as well as the contractor, from claims or financial loss in the event of injury or damage during the course of the work. When insurance is in force, claimants normally look to the insurance for a prompt settlement of their claims. Without insurance, however, lawsuits are often filed in an attempt to collect damages from any party with assets who might have been responsible for causing the problem.

The AIA General Conditions requires the contractor to carry several different types of insurance to protect against loss from various categories of potential claims. It is the owner's responsibility and prerogative to stipulate exactly which types of insurance coverage and the limits of coverage (how much insurance) the contractor must carry for the project. Often, because of the architect's experience from previous projects, the owner will ask the architect for advice about insurance coverage and limits. The architect should never give insurance advice, because he or she is not an insurance agent or broker and his professional liability insurance does not cover claims arising out of the giving of insurance advice. Instead, the architect should offer to assist the owner's insurance agent in determining which and how much insurance is appropriate for the project. The architect can tell the owner what his or her experience on prior similar projects has been, but the architect should make it very clear that he or she is not making any recommendations about insurance for the specific project, and that the final decision about insurance

must be made by the owner on the basis of professional insurance advice.

To assist the architect in dealing with the owner on matters of insurance, as well as to document the owner's instructions about insurance coverages and limits for the project, AIA has developed Document G610, Owner's Instructions for Bonds and Insurance. This form is in the nature of a checklist that can be used by the owner and his insurance agent to decide which bonds and insurance will be required, as well as for the limits of coverage. After the form is completed by the owner, it is sent to the architect so that the owner's bond and insurance requirements can be inserted into the bidding and contract documents for the project.

Another helpful AIA document in regard to establishing insurance requirements is Guide for Supplementary Conditions, AIA Document A511. The insurance requirements in the AIA General Conditions are general insurance requirements. These provisions must always be supplemented in the Supplementary Conditions to establish specific project insurance requirements and limits of coverage. The AIA General Conditions can never be used without appropriate supplementary conditions in regard to insurance requirements. The AIA Guide for Supplementary Conditions (A511) provides guidance and helpful sample language in this regard.

To provide a detailed analysis of bonds and insurance, AIA publishes "Construction Bonds and Insurance" (2nd Edition), by Bernard B. Rothschild, FAIA. This publication is a detailed analysis of bond and insurance requirements contained in the AIA standard construction documents, and it includes sample contract language, a glossary of insurance terminology and sample insurance policies. This is a "must" publication for anyone making a detailed study of this subject.

By law, all employers must carry workers' compensation insurance to protect employees in case of job related injuries. Therefore, the contractor is required, by clause 11.1.1.1 of the AIA General Conditions, to carry this coverage for his construction workers. The theory behind workers' compensation insurance is that job related injuries can and do occur, and that workers should be able to get a prompt and fair insurance settlement instead of having to bring a lawsuit in order to recover damages for their injuries. The employer is required by law to pay the premiums for workers' compensation insurance (although this is included in the contractor's overhead costs and is reflected in his bid prices).

By statute, the employer who is required to pay the workers' compensation insurance premium is given immunity from a separate lawsuit by the worker who collects the insurance benefit after an injury. The worker, however, is not precluded from suing any other party who might have been responsible for the injury. Thus, an architect may be sued directly by a construction worker after he is injured and collects workers' compensation insurance benefits. Because the worker cannot sue the contractor, who is immune from suit as the party who paid the workers' compensation insurance premiums, the injured worker can look for a third party to sue (i.e., the architect) if he does not

feel the insurance has provided adequate compensation.

These so-called third party suits are based on the idea that the architect somehow had a legal duty to properly direct and manage the construction work. If the plaintiff can establish that the architect had this duty, and that the architect breached the duty, the architect can be held liable for the injuries. For this reason, the word "supervision" should never be used to describe the architect's construction phase services, or as a synonym for construction contract administration. Several court decisions have held that "supervision" means, legally, a right to manage, direct and control. When supervision is used in the context of a construction project, it is intended to describe the contractor's function -- the contractor, and not the architect, directs, manages and controls the construction work. If the architect has a contractual obligation to "supervise," he can be held liable for any injuries or damage that occur because he failed to properly direct, manage and control the construction work. Thus, to avoid liability to construction workers and to limit their recovery for job related injuries to the workers' compensation insurance, an architect should not undertake, by contract or otherwise, any duties that might be interpreted as part of the contractor's scope of work.

Other liability insurance required of the contractor covers claims by his employees that are not covered by workers' compensation insurance, claims by non-employees because of bodily injury, sickness or disease, and claims for damages insured by the usual personal injury liability coverages (i.e., libel, slander and the like). In addition, the contractor is required to carry insurance for claims for damages other than to the work itself (an adjacent building, for example) and for claims arising out of the ownership, maintenance or use of a motor vehicle. The contractor's workers' compensation insurance, employer's liability insurance, comprehensive general liability insurance, personal liability insurance and automobile liability insurance policies normally protect against the claims described above.

An important adjunct to the contractor's insurance coverages is required by clause 11.1.1.7 of the AIA General Conditions (A201). This provision requires the contractor's insurance to include "contractual liability insurance" applicable to the contractor's obligations to indemnify and hold the owner and architect harmless from certain types of claims, as set forth in paragraph 3.18 of the AIA General Conditions. Contractual liability insurance provides coverage for a liability assumed by contract. A contractual provision calling for indemnification is a contractually assumed liability. Paragraph 3.18 requires the contractor to indemnify the owner and architect if they are sued by a construction worker who is injured during the course of the work. By requiring contractual liability insurance, usually written by an endorsement to the contractor's comprehensive general liability policy, the owner and architect can be assured that there is a party with financial responsibility (the insurance company) standing behind the contractor's

obligation to indemnify them in the event of this type of claim.

Owner's Insurance

The owner has an insurable interest in the work as it progresses. Under the provisions of the AIA General Conditions and many non-AIA construction contracts, title to the work passes to the owner each month as the owner makes the progress payments to the contractor. Because of this, it is considered appropriate for the owner to carry the insurance on the property itself. On occasion, the contractor, rather than the owner, will be required to carry the property insurance. This occurs when the owner is relatively unsophisticated and does not want to have the responsibility for the property insurance or when the contractor can arrange this coverage more conveniently than the owner can. In any event, it should be recognized that the AIA General Conditions place the responsibility for carrying the property insurance with the owner. If the contractor is to carry the property insurance, the AIA Guide for Supplementary Conditions (A511) contains suggested language to achieve this objective.

The property insurance is sometimes referred to as the "builder's risk" or the "builder's risk-all risk" insurance. Because the insurance is often carried by the owner, this name ("builder's risk") is somewhat a misnomer. In addition, the coverage is defined by the policy terms, conditions and exclusions (as with all insurance), so it does not cover "all" risks. And, this coverage can be written on a "specified perils" basis rather than on an "all risk" basis.

The function of the property (or "builder's risk") insurance is to protect the property itself against such risks as fire, theft, vandalism and malicious mischief. Typically, the coverage is written for the "full insurable value" of the work on either a completed value" or a "reporting" form. The "completed value" is coverage for the full value of the work, with a single premium paid. The "reporting" form requires a monthly adjustment as the value of the work increases during construction. If it is to be for a lesser amount, the owner is obligated to notify the contractor prior to commencement of the work so that he can arrange his own coverage to further protect himself and the subcontractors. The cost of arranging this latter coverage can be charged to the owner. The AIA General Conditions also requires the owner to maintain boiler and machinery insurance, if required by the contract documents or by law.

If a loss occurs which is covered by the property insurance, the owner is required to act as a trustee for the insurance proceeds received in the event of a covered loss. (If the contractor is carrying the property insurance, the contractor would act as the trustee in the event of a loss.) The owner is required to pay the contractor, and the contractor in turn to pay the subcontractors, a just share of the insurance proceeds received in settlement of claims. Funds received in settlement of claims should be placed in a separate account, pending distribution to the parties.

Normally, if a loss occurs, the owner or his attorney will become deeply involved in the situation, but they

may look to the architect for technical assistance. The architect should limit his or her involvement to providing professional advice. He or she should not attempt to determine the rights of the respective parties, act as a custodian for the insurance proceeds, or make any determination about how the proceeds are to be distributed. These decisions must be made by the owner on the basis of advice from his attorney.

There are a couple of other aspects of the property insurance that the architect needs to be aware of. One is the concept of subrogation. Subrogation is a procedure by which an insurance company, after it pays a loss to its insured, can attempt to recover this amount from some other party who may have actually caused the loss. An insurance company cannot recover from its own insured, whether or not the insured was at fault. However, if someone else was at fault, the concept of subrogation enables the insurance company to "step into the shoes" of its insured in an attempt to recover its loss.

The standard AIA General Conditions contains a waiver of subrogation clause (subparagraph 11.3.7) which precludes the parties from seeking to recover any money from each other for any loss covered by the property insurance. Because the parties are waiving their rights to recover from each other, the property insurance company would not have any right to do so either (the insurance company has no greater rights than its insured). Most insurance policies prohibit the insured from waiving any rights after a loss occurs, but it is not customary for the policy to prohibit this prior to the occurrence of a loss. Presumably, if the insurance company is aware of the contract terms calling for the waiver, it can determine the appropriate premium, knowing that it will not be able to offset any amount paid out in the event of a loss.

Another aspect of the property insurance involves occupancy of the work by the owner prior to substantial completion. If it becomes necessary for the owner to occupy the work prematurely, the contractor and the company providing the property insurance must agree to this. The insurance company's consent must be evidenced by an endorsement to the insurance policy.

The above discussion covers the standard property insurance coverages for a typical project. Neither the owner nor the contractor are limited to the standard coverages. If special project requirements or personal concerns of either party necessitate additional coverages, the parties can seek the advice of their insurance agents and attempt to arrange whatever insurance is deemed appropriate to protect against the risk of loss.

Certificate of Insurance

The Certificate of Insurance is a memorandum which outlines the types and limits of the insurance coverages carried by the contractor for the project. Subparagraph 11.1.3 of the AIA General Conditions (A201) requires the contractor to provide certificates of insurance acceptable to the owner; the certificates must contain a provision stating that the owner will be given at least 30 days' prior written notice before the underlying insurance policies can be canceled.

The notice requirement gives the owner (and the contractor) a reasonable opportunity to arrange replacement coverage or effect a termination of the contract if replacement insurance cannot be arranged.

AIA has developed Document G705, Certificate of Insurance, to facilitate the subdivision of this informa tion. The certificate of insurance must be filed with the owner before the work commences. If the certificate is sent by the contractor to the architect, the architect should promptly forward it to the owner with instructions that it be reviewed by the owner's insurance agent for a determination whether the contractor's insurance coverages comply with construction contract requirements.

The Certificate of Insurance is normally prepared (and signed) by the contractor's insurance agent, and there can be no guarantee that he studied contract requirements carefully before completing the form. There is always the possibility that the contractor's insurance agent simply listed on the certificate of insurance the coverages normally carried by the contractor, rather than the coverages required by the contract documents. The owner's insurance agent, and not the architect, should analyze the certificate of insurance for compliance with contract requirements. If it does not appear that the contractor's insurance is in compliance, the architect should be notified immediately so that he can inform the contractor not to commence work until the proper insurance is arranged. If the required insurance is not in force prior to the commencement of the work, there is a real danger that an uninsured loss could occur.

There is no requirement in the AIA General Conditions that the owner must file a Certificate of Insurance with the contractor. Thus, there is no AIA form to serve as a certificate for the insurance carried by the owner for the project. However, subparagraph 11.3.6 of the AIA General Conditions requires the owner to "file with the Contractor a copy of each policy that includes insurance coverages required" of the Owner before an exposure to loss occurs. In other words, for those insurance coverages taken out by the owner, the contract requires the owner to give a copy of each policy to the contractor. Here, too, the architect's role is limited to transmitting the documents. The architect should not make any substantive judgments or recommendations about the adequacy of the owner's insurance. If the contractor has any concerns in this regard, he should direct them to the owner (via the architect).

SUBCONTRACTORS AND MATERIAL SUPPLIERS

Subcontractors and material suppliers are parties who have contracts with the general contractor to provide labor and/or materials required in connection with the work. There is no contractual relationship between the owner (or the architect) and subcontractors and material suppliers. Contractors generally are very sensitive about their contractual relationships with subcontractors and material suppliers and object to any interference by the architect with these relationships. Except under narrowly prescribed circumstances, the architect should not

communicate directly with subcontractors and material suppliers. All such communications should be directed to and through the contractor. This is a two-way street, however, and all communications from subcontractors and material suppliers also should come through the contractor to the architect. This is particularly appropriate in regard to shop drawing and sample submittals, which should not be accepted by the architect if they have not been checked and approved by the contractor first. This will be covered in detail in Lesson 2.

Article 5 of the AIA General Conditions, requires the contractor, as soon as practical after the award of contract, to give the owner and the architect written notice about who the contractor proposes to hire for major portions of the work. Although the owner does not have a right of prior approval for subcontractors, the contract gives the owner and the architect the right to raise reasonable and timely objections to any subcontractors or material suppliers. If the owner or the architect has a reasonable objection, the contractor is precluded from contracting with any such party. In that case, the contractor must subcontract with someone else, and the owner will be liable for any increased costs. Paragraph 5.3 of the AIA General Conditions (A201) requires that all subcontracts be in writing so that the subcontractor is bound to the contractor, to the extent of the work to be performed, to the same extent that the contractor is bound to the owner. If the contract is based on documents other than the standard AIA General Conditions, the architect should review the contract carefully to determine the scope of his authority in regard to approving or rejecting subcontractors and material suppliers.

As noted above, the architect should refrain from communicating directly with subcontractors and material suppliers. It may be tempting for an architect, in the interest of expediting construction, to speak directly with a subcontractor or his field superintendent in order to give instructions, discuss changes or pass judgment on the quality of workmanship. If the architect does this, however, he or she runs a real risk of inviting a claim by the contractor that the architect's communication has increased costs, caused delay or otherwise interfered with the contractor's ability to properly supervise and manage the construction process. All such communications should always be directed by the architect to the contractor, with some minor exceptions which will be discussed elsewhere.

ARBITRATION

General arbitration concepts were covered in detail above, but there also are a couple of related aspects of dispute resolution during construction contract administration that directly involve the architect. Under standard contract documents, the architect serves as the initial decision maker when disputes arise between the owner and contractor, and the architect can be called as a witness in any ensuing arbitration proceeding.

Architect's Role as Initial Decision Maker

The standard AIA Owner-Architect Agreement (B141) requires the architect to interpret the drawings and

specifications and make decisions on matters in question between the owner and contractor. Subparagraphs 2.6.15 and 2.6.16 state:

2.6.15 "The Architect shall interpret and decide matters concerning performance of the Owner and Contractor under the requirements of the Contract Documents on written request of either the Owner or Contractor. The Architect's response to such requests shall be made with reasonable promptness and within any time limits agreed upon."

2.6.16 "Intrepretations and decisions of the Architect shall be consistent with the intent of and reasonably inferable from the Contract Documents and shall be in writing or in the form of drawings. When making such interpretations and initial decisions, the Architect shall endeavor to secure faithful performance by both Owner and Contractor, shall not show partiality to either, and shall not be liable for results of interpretations or decisions so rendered in good faith."

These provisions are paralleled in the AIA General Conditions in subparagraphs 4.2.11 and 4.2.12, which bind the owner and the contractor to initially refer claims, disputes and other matters in question to the architect for a decision. Because the architect is familiar with the contract documents and does not have an economic stake in the construction contract, the law gives the architect a quasi-judicial immunity when he serves in the role of an initial decision maker after such disputes or claims arise. This means that the architect cannot be held liable for the consequences of any decisions he makes in good faith, whether or not the decisions favor the owner or the contractor. The architect may not show partiality to either party when he serves in this role.

The architect's decisions and interpretations must be consistent with the intent of, and be reasonably inferable from, the contract documents. If the matter in question involves aethetic effect, the architect's decision is final (if consistent with the intent of the contract documents). Other decisions are subject to arbitration upon written demand by either the owner or the contractor. After a matter is referred to the architect for a determination, the AIA General Conditions require the architect to act within specified time limits. Specifically, neither party can demand arbitration until the architect has rendered a written decision or until 10 days after the parties have presented their evidence to the architect (if the architect has not rendered a decision by that time). These limitations do not apply of the position of Architect is vacant, if the Architect fails to act within 30 days, or if the claim relates to a mechanic's lien (A201, Subparagraph 4.3.2). The time within which the parties must demand arbitration of a dispute depends on the nature of the architect's decision. If the decision is in writing and states that it is "final but subject to arbitration" (A201, clause 4.5.4.1), and further states that any demand for arbitration must be made within thirty days, a failure to demand arbitration will result in the architect's decision becoming final and binding.

The architect's role as the initial decision maker is a logical extension of his role as the party who prepared the drawings and specifications. By being familiar with the documents, the architect normally can make a prompt and knowledgeable determination, based on the intent of the contract documents, when either the owner or the contractor has a question or when a dispute arises between them about contract requirements. Except in regard to aesthetic effect, the architect's decisions are always subject to appeal by means of a demand for arbitration. If both the owner and the contractor are satisfied with the architect's decision, the matter ends there, and no one will be put to the expense and inconvenience of having to refer the matter to an outside party for resolution. If either party is dissatisfied with the architect's decision, he has the option of taking it further by demanding arbitration. If the architect were not permitted to make initial determinations, every question or dispute would have to be referred to an outside party whenever the owner or the contractor disagreed about the intent of the contract documents.

Architect as a Witness

In the AIA Owner-Architect Agreement (B141), subparagraph 3.3.8 commits the architect to provide services in connection with any public hearings or arbitration or legal proceedings involving the project. This service is performed as an Additional Service, with the architect being compensated for his time to prepare and serve as a witness or perform other services.

The architect could be called as a witness because of his knowledge of facts connected with the project, or he could be called as an expert witness because of his technical expertise as a design professional. As an expert witness, the architect's function is to aid the court or arbitration panel by giving testimony about things of a technical nature that may be beyond the scope or knowledge of the judge, jury or arbitrator who will be deciding the case. Often, this involves testimony about what is the professional standard of care during the performance of services or what is customary practice in the construction industry in regard to the issues before the court or arbitration panel.

It is important for the architect to recognize that, when testifying as an expert witness, he must be factual, objective and knowledgeable about construction industry practices related to the issues under deliberation. He cannot "shoot from the hip" but must base his testimony on an adequate independent investigation of the facts before forming his opinions. Otherwise, the architect runs the risk of being embarrassed on cross-examination and having his credibility as a witness and as a professional seriously undermined.