Essential Construction Contract Terms: Avoiding Future Problems by Addressing Key Issues

Thomas L. Rosenberg

This article provides an introduction to some key terms and concepts that will aid in drafting construction contracts with a view toward minimizing potential disputes.

Many construction disputes can be avoided by careful planning during contract formation. The specific terms and concepts discussed below, which are used in contract drafting, include:

(A) incorporation by reference
(B) scope of work
(C) right to stop work
(D) payment
(E) exculpatory clauses
(F) notice
(G) warranties
(H) termination for cause and convenience
(I) change orders and changed conditions, and
(J) pay-if-paid and pay-when-paid clauses

There are several sources of form contracts available for construction contracts, including the American Institute of Architects,[1] the Engineers Joint Documents Committee,[2] and the Associated General Contractors.[3] Because the American Institute of Architects (''AIA'') is especially popular, the discussion below will proceed by introducing each issue, examining any provisions in AIA Document A201-1997[4] dealing with that issue, and Ohio law as an example state statute relating to the issue.

Thomas L. Rosenberg is a partner at Roetzel & Andress, LPA, a full service law firm with offices throughout Ohio and Florida, as well as an office in Washington D.C. Mr. Rosenberg practices construction law and has represented architects, engineers and contractors for over 23 years. This article is based on a presentation at a Lorman Educational Services Seminar. Mr. Rosenberg can be reached in the Columbus, Ohio, office of Roetzel & Andress at (614) 723-2006 or trosenberg@ralaw.com.

Incorporation by Reference

The construction contract itself typically does not explicitly address every detail of the parties' agreement. Ohio law therefore permits parties to incorporate other documents into the construction contract by reference.

If the contract incorporates the general conditions of AIA Document A201-1997, Article 1.1 provides that the contract documents include the Agreement between Owner and Contractor, the Conditions of the Contract, Drawings, Specifications, Addenda issued before the contract is executed, and Modifications made after the contract is executed. Article 1.1 further provides that other documents, including those relating to the bidding process, are not part the contract unless explicitly provided for in the Agreement between Owner and Contractor.

Generally, Ohio courts hold that when a contract recites that it incorporates some other document, that document becomes part of the contract.[5] In the con-

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 1

struction context, ''[w]here the plans and specifications are by express terms made a part of the contract, the terms of the plans and specifications will control with the same force as though incorporated in the very contract itself.''[6] Further, ''[e]very contract of a sub-contractor and every contract with a sub-contractor is deemed to have been executed with reference to the original plans and specifications and alternates covered and included within the general contract, unless something to the contrary expressly appears in the particular contract under consideration.''[7]

Under Ohio law, the default position is that the contract does not incorporate other documents unless it specifically identifies such documents. Subcontracts between the contractor and subcontractors are interpreted in light of the general contract. Thus, parties have a good deal of freedom in determining what documents will be incorporated into the contract, but should be mindful that incorporation of AIA Document A201-1997 results in the incorporation of a standard set of general conditions and documents into the construction contract.

Scope of Work

Generally, the contractor and each subcontractor involved in a construction project has a scope of work. For the contractor, the scope of the work is defined by the construction contract. For subcontractors, the work scope is also contractually defined, but will differ for each subcontractor (e.g. the plumber does the plumbing; the electrician does the electrical work). The scope of work is important because a contractor or subcontractor is not obliged to perform work that is beyond the contractual scope of work (e.g. the plumber is not obliged to perform electrical work).

The scope of work becomes especially important when the owner issues a change order, requiring the contractor or subcontractor to perform duties that may be an extension of the scope of work, a modification to the scope of work, or beyond the scope of work. Any changed or extra work ordered by the owner which exceeds the scope of the contract work may in certain circumstances be considered a cardinal change. A cardinal change is considered a breach of contract, and allows the contractor to stop work until the parties reach an agreement regarding the work beyond the contractual scope of work. Although AIA Document A201-1997 and most construction contracts provide for changed and extra work, a cardinal change is by definition beyond the scope of the contract.

It is uncertain whether Ohio courts follow the cardinal change doctrine as enunciated by the United States Court of Claims in *General Dynamics Corp. v. United States*: ''[a]n order change determined to be outside the scope of the contract is an abuse of the contract right ... and is a cardinal change .... Generally such a change represents a large increase in the contract burdens.''[8] In Ohio, similar reasoning was employed in *Tony Zumbo & Son Const. Co. v. Ohio Dept. of Transp.*, where the court found that the owner breached by insisting that the contractor perform work beyond the scope of the contract.[9] It is important to note, however, that while there is no case law indicating that the cardinal change doctrine has not been adopted in Ohio, an Ohio court may be reluctant to apply it.[10] Additionally, changed or extra work may not necessarily be beyond the contractual scope of work. Changed and extra work clauses are commonly included in construction contracts, and changes within the scope of work made pursuant to these clauses are binding on the contractor.

Scope of work disputes tend to focus on the cause of the extra work and whether the work exceeds the scope of the contract. The cause of the extra work was the issue in *Lathrop Co. v. City of Toledo*,[11] which involved a dispute related to the extra work of repainting a bridge over the Maumee River. The bridge had to be repainted because the original coat had begun to peel when the contractor was halfway through the job. The Supreme Court of Ohio held that the owner's specification of the paint to be used-and not the contractor's workmanship-was the cause of the peeling, and ordered the owner to compensate the contractor for the extra work.

Whether the extra work exceeded the scope of the contract was the issue in *Associated Maintenance & Roofing Co., Inc. v. Rockwell*,[12] in which the court found that extra material and labor costs incurred by the contractor in performing the contract work of replacing a building's roof, though unexpected, did not rise to the level of beyond the scope of work. The court in *Kelchner Excavating, Inc. v. Gene Zimmerman, Inc.*,[13] reached a similar result. In that case, the dispute was whether work and materials furnished to clean debris from a street between phases of a contract to construct sewers and streets was beyond the scope of a contract. The cleaning was necessitated by public use of the street between phases, and the court held that it was not beyond the scope of work when all parties to the contract knew that the street would be publicly used between construction phases.

Right to Stop Work

The right to stop work is distinct from the right to terminate the construction contract. While termination is permanent, a work stoppage lasts only until the cause of the delay is resolved. Every construction contract should address the conditions under which each party has the right to stop work and who should bear the costs for the work stoppage or delay.

Article 2.3 of AIA Document A201-1997 provides that if the contractor fails to perform the work in accordance with the construction contract, the owner may issue a written order to the contractor to stop work. Further, under Article 9.7, the contractor may stop the work if the owner does not promptly pay the contractor.

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 2

In order for the contractor to stop work for nonpayment, it must wait seven days after payment is due and provide written notice to the owner and architect that it will stop work if payment is not received within an additional seven days. The contract time is then extended until payment is made and the contract price is increased to include the contractor's reasonable costs incurred in stopping work. Article 10.3.1 provides that the contractor may also stop work if hazardous materials at the work site render performance unsafe. Under Articles 10.3.2-10.3.3, the contractor must notify the owner immediately of the hazardous condition and may delay work without penalty until the hazardous materials are removed or rendered harmless. Finally, Article 14.3 deals with suspension, and provides that the owner may order the contractor to suspend work for whatever period of time it desires.

In Ohio, the party responsible for a work stoppage or delay is liable to the other party for damages flowing from the delay.[14] Thus, if a party exercises its rights under a right to stop work clause, the party responsible for the stoppage must compensate the other party for costs incurred as a result of the delay. Further, Ohio law holds that, even in the absence of a right to stop work clause, an owner has a duty to provide a site on which the contractor can perform its work, and hazardous work site conditions have been interpreted to violate this duty.[15] Thus, if a contractor stops work because of a hazardous work site, the owner will be liable to the contractor for all costs resulting from the stoppage.

Payment

Payment is the primary concern of most parties to a construction contract. The contract should clearly define the manner in which payment is made, and specifically address progress payments, retainage, time for payment, and final payment.

AIA Document A201-1997, Article 9 deals with payment. Article 9.2.1 requires the contractor to submit a schedule of values to assist the architect in evaluating the contractor's applications for payment. This schedule of values must be prepared and supported in order to allow the architect to substantiate the contractors' claims. Article 9.3 governs applications for payment, which the contractor submits to the architect. After receiving the contractor's applications for payment, the architect issues a certificate for payment to the owner pursuant to Article 9.4. By the certificate for payment, the architect certifies to the owner that, to the best of the architect's knowledge, information, and belief, the work is in accordance with the construction contract. Article 9.5.1 provides that the architect may withhold certification for all or part of the amount of the contractor's application for payment if the architect cannot make the Article 9.4 certification. If certification is thus withheld, the architect may issue a certification for payment for that portion of the work the architect can certify has been completed in accordance with the terms of the contract.

Retainage is a portion of the contract price paid into an escrow account before substantial completion of the work, and is beneficial to both the owner and the contractor. For the owner, retainage ensures that the project is completed, protecting against default by the contractor. And for the contractor, retainage protects against default by the owner. The Ohio Revised Code requires public owners to establish an interest bearing, escrow account for all retainage withheld.[16]

Although in the past construction contracts provided for progress payments on dates certain, today most construction contracts provide a period of time for the owner to make payment after the contractor submits an application for a progress payment. During this time, the architect inspects the work to ensure it conforms to the contract before submitting a certificate for payment to the owner. The owner then makes the necessary arrangements to pay the contractor. Ohio law generally respects the parties' payment arrangements. The Ohio Prompt Payment Act provides that contractors must promptly pay subcontractors and suppliers, but does not address the time for payment by the owner to the contractor.[17]

The final payment is distinct from, and entails more than, progress payments. In addition to the requirement that the work conform to the contract, the owner typically attaches certain conditions to the contractor's receipt of the final payment. These conditions often require the contractor to release any lien claims it might have and make certain express warranties regarding the contract work.

Exculpatory Clauses

Exculpatory clauses shield a party from certain types of liability. For reasons of public policy, Ohio law limits parties' ability to disclaim all liability.

Ohio Revised Code Section 4113.62 provides that certain ''provision[s] of a construction contract, agreement, or understanding'' are ''void and unenforceable as against public policy.''[18] First, the statute invalidates any provision that ''waives rights under a surety bond.''[19] Second, any provision that ''waives any pending or asserted claim on the basis of final payment made'' is void and unenforceable.[20] Third, any contract provision that ''waives or precludes liability [or any other remedy] for delay during the course of a construction contract when the cause of the delay is a proximate result of the owner's act or failure to act'' is void.[21] Fourth, the statute invalidates any subcontract provision that ''waives or precludes liability [or any other remedy] for delay during the course of a construction contract when the cause of the delay is a proximate result of the owner's or contractor's act or failure to act.''[22] Similarly void is any contract for an improvement to real estate in Ohio that either makes the contract subject to the laws of another state or that

requires dispute resolution to take place in another state.[23]

No Damage for Delay Clause

In addition to the prohibited clauses described above, an exculpatory clause commonly included in construction contracts is a ''no damage for delay'' clause. Ohio law provides that such clauses are generally valid and enforceable. In *Carrabine Const. Co. v. Chrysler Realty Corp.,*[24] the court denied the contractor's claim for costs incurred in delaying work until the owner arranged for the proper zoning of the construction property when the contract contained a no damage for delay clause.

However, when the delay is not reasonably contemplated by the parties at the time of contract formation, a ''no damage for delay'' clause does not deny the contractor recovery for additional costs. In *Nix, Inc. v. Columbus,*[25] the court held that a ''no damage for delay'' clause was inapplicable where all parties to the contract assumed that the owner had a right-of-way needed for construction, and the construction was delayed because the owner did not actually have the right-of-way. Also, it is important to remember that R.C. 4113.62(C)(1) provides that a ''no damage for delay'' clause is void if the delay is the proximate result of the owner's act or failure to act. R.C. 4113.62(C)(2) similarly invalidates such clauses in a subcontract if the delay is the proximate result of the contractor's failure to act.

Site Inspection Clause

A site inspection clause requires the contractor to inspect the work site to verify the accuracy of the owner's description of the site. If the construction contract contains such a clause, the contractor must comply with its duty to inspect before it may recover for differing site conditions. AIA Document A201-1997, Article 3.2.1 requires the contractor to observe the site conditions that may affect the work. It is unclear whether ''observe'' in this context requires the contractor to discover and hold the contractor harmless for differing site conditions.

Indemnity Clause

Another common exculpatory construction contract clause is an indemnity clause, whereby the indemnitor (usually the contractor) must compensate the other party for any losses related to the activity specified in the contract. Ohio law prohibits clauses which make the indemnitor liable for damages where the indemnitee is solely responsible for the injury.[26] However, Ohio courts have narrowly construed this statutory limitation on indemnity clauses. In *Brzeczeh v. Standard Oil Company*,[27] the court upheld a clause requiring the contractor to obtain liability insurance naming the owner as an additional insured. Similarly, in *Moore v. Dayton Power and Light Company*,[28] the court upheld a clause providing that the contractor would indemnify the owner for all costs and expenses arising from injury. The *Moore* court distinguished costs and expenses from damages, and found that only clauses requiring indemnification of damages were statutorily prohibited.

Design Delegation Clause

AIA Document A201-1997, Article 3.12 allows the owner to delegate design responsibility to the contractor. If the construction contract specifically requires a contractor to provide design services and specify design and performance criteria, a contractor is to procure those design services from a licensed design professional. Failure to do so may violate Ohio law relating to unlicensed design practice.

Waiver of Consequential Damages Clause

Construction contracts also frequently include a mutual waiver of consequential damages clause, whereby both parties agree to waive all consequential damage claims relating to the contract. Such a clause is included in Article 4.3 of AIA Document A201-1997. Consequential damage waivers may amount to no damage for delay clauses when costs arising from delays are characterized as consequential. Again, it is important to note that R.C. 4113.62(C)(1) invalidates such a clause if the delay is the result of the owner's act or failure to act, and R.C. 4113.62(C)(2) similarly invalidates a waiver of consequential damages clause in a subcontract if the consequential damages are the result of the contractor's act or failure to act.

Liquidated Damages Clause

Finally, liquidated damages clauses are another common feature of construction contracts, especially contracts in which time is of the essence. Generally, liquidated damages clauses in construction contracts provide that the contractor must compensate the owner for every day construction extends beyond the end date specified in the contract. In *Jones v. Stevens*, the Ohio Supreme Court enunciated the standard for evaluating whether a contract provision specifying the amount of damages for breach is a valid liquidated damages clause or a forbidden penalty clause:

> Where the parties have agreed on the amount of damages, ascertained by estimation and adjustment, and have expressed this agreement in clear and unambiguous terms, the amount so fixed should be treated as liquidated damages and not as a penalty, if the damages would be (1) uncertain as to amount and difficult of proof, and if (2) the contract as a whole is not so manifestly unconscionable, unreasonable, and disproportionate in amount as to justify the conclusion that it does not express the true intention of the parties, and if (3) the contract is consistent with the conclusion that it was the intention of the parties that damages in the amount stated should follow the breach thereof.[29]

Also, a liquidated damages clause is likely to be interpreted as an unenforceable penalty if the liquidated damages calculation is so high that it appears calculated to deter a breach of contract.[30]

Notice

In order to be paid for additional costs incurred in per-

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 4

formance, a contractor must provide the owner adequate notice of such claims. Whether notice is adequate will generally depend on whether the timing and substance of the notice conform to the notice requirements in the contract.

AIA Document 201-1997, Article 4.3.2 provides that claims must be initiated by notice to the architect or other party within 21 days of recognition of the condition giving rise to the claim. Article 4.3.4 further provides that if the claim is the result of a concealed physical condition, the claimant must provide notice before the condition is disturbed and within 21 days of discovery of the condition. Article 4.3.8 also requires notice within 21 days for claims of injury or damage to person or property.

Traditionally, Ohio courts have held that actual notice pursuant to the contract is not necessarily required if the owner had constructive notice of the additional costs. In *Roger J. Au & Son, Inc. v. Northeast Ohio Regional Sewer Dist.*,[31] the court held that the contractor's failure to follow the contractual notice procedure regarding differing subsurface site conditions did not bar recovery where the owner had actual knowledge of the changed condition. The court reasoned that the purpose of the notice requirement was fulfilled if the owner was aware of the changed condition.

However, the recent case of *Dugan & Meyers Construction Co, v. Ohio Dept. of Administrative Services*[32] has cast significant doubt on whether a contractor may recover without following the contractual notice requirement. In *Dugan & Meyers*, the Franklin County (Ohio) Court of Appeals held that the contractor's failure to follow the notice requirement in the contract regarding a time extension waived any claim by the contractor for extension of time or mitigation of liquidated damages. The case involved Phase II of the construction of the Fisher College of Business at the Ohio State University. Construction Delays were sustained by the contractor, and it submitted a claim to the State for additional compensation, which was rejected. Dugan & Meyers sued, and the trial court awarded the contractor over $2 million.

Article 8 of the construction contract that Dugan & Meyers had, provided that the contractor must notify the owner within ten days of the occurrence of the facts constituting the basis for the claim for additional compensation, and that failure to do so results in waiver of the claim. Dugan & Meyers did not follow the Article 8 procedure to provide notice of the delays, arguing that notice would have been futile. Despite finding that the owner (''OSU'') had knowledge of the delays to the project and had allegedly made it clear that no requests for time extension would be granted, the court of appeals held that the futility of the notice was not established, and even if the request for additional time would have been futile, Dugan & Meyers was contractually bound to follow the notice procedure or waive the claim.

In finding that Dugan & Meyer's failure to follow the notice provision for delays in the construction contract barred recovery, the court's opinion runs contrary to the traditional rule that following the notice provisions in the contract is not required when the owner is aware of the delay and/or the extra costs incurred because of the delay. The owner was aware of the delay to the project and had made it clear that no time extensions would be granted. Thus, it cannot be said that the owner was unaware of the condition or that the purpose of the formal notice was unfulfilled. The legacy of *Dugan & Meyers* is uncertain; the case is before the Ohio Supreme Court on appeal. For the present, however, it stands as an opinion that, if unaltered, may deny payment to any contractor who does not follow the notice and claims provisions in a construction contract.

Warranties

Warranties can be either express or implied. Contractors will be held to any express warranties made in the construction contract. The express warranty is often the one specified in AIA Document A201-1997, Article 3.5.1, which provides (1) that the materials and equipment furnished under the contract will be of good quality and new unless otherwise required or permitted by the contract, (2) that the work will be of good quality, and (3) that the work will conform to the contract. Article 12.2.2.1 further provides that the express warranty lasts one year from the date of substantial performance. Contractors should refrain from making other statements in the contract relating to the quality of the work because such provisions may be construed as warranties.[33]

In addition to express warranties, which may vary depending on the contract, Ohio law imposes certain implied warranties which bind the parties unless explicitly disclaimed. Implied warranties include the common-law warranty that the contractor will perform his duties in a workmanlike manner and the warranty that the plans and specifications provided by the owner are sufficient to allow the contractor to perform. Regarding the warranty that the contractor will perform in a workmanlike manner, ''[i]t is the duty of the builder to perform his work in a workmanlike manner; that is, the work should be done as a skilled workman would do it; the law exacting from a builder ordinary care and skill.''[34]

In *McMillan v. Brune-Harpenau-Torbeck Builders, Inc.*, the Ohio Supreme Court extended this duty to run not only from the contractor to the owner, but also to all subsequent owners of the property: ''[i]f the violation of that duty proximately causes a defect hidden from revelation by an inspection reasonably available to [any vendee, original or subsequent], the vendor is answerable to the vendee for the resulting damages.''[35] The duty to perform in a workmanlike manner further warrants that the contractor has employed reasonable care and skill in the selection of materials.[36]

In addition to the warranty that the contractor has performed in a workmanlike manner, there is also the warranty that the plans and specifications provided by the owner are sufficient to allow the contractor to perform. In *United States v. Spearin*,[37] the United States Supreme Court held that there is an implied warranty which imposes a duty on the owner: the warranty of design or sufficiency of plans and specifications. ''[I]f the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications.''[38]

In *Mason Tire & Rubber Co. v. Cummins-Blair Co.*,[39] the owner was held liable for delay caused by inadequacy of plans and specifications, as well as deficiencies in the architect's performance on an agency theory. In *D.M. Sylvester & Dipaolo Construction Co. v. Village of North Randall*,[40] the owner was held liable to the contractor for compensation for extra work in installing a water line in a location other than that specified in the plans and specifications; an existing gas line had made installation in the contemplated location impossible. Similarly, in *Bates & Rogers Construction Co. v. Board of Commissioners of Cuyahoga County,*[41] the court held that the owner had to compensate the contractor for extra costs incurred when the contractor had to excavate to a greater depth than called for by the plans and specifications.

In addition to the implied warranty of sufficiency of the plans and specifications, Ohio law also imposes on the owner the duty to provide a site upon which the contractor can perform the work. In *Valentine Concrete, Inc. v. Ohio Dept. of Adm. Serv.*,[42] the court found that the owner's failure to provide an adequate worksite allowed the contractor to recover the costs flowing from the delay caused by the owner's breach. The recent case of *Dugan & Meyers Construction Co, v. Ohio Dept. of Administrative Services* has drawn into question the status of the *Spearin* Doctrine in Ohio.

Ohio law permits parties to disclaim implied warranties. For a disclaimer to be effective, the contract must contain clear, express, and unambiguous language to the effect that there are no warranties other than those specifically set forth in the contract.[43]

Termination for Cause or for Convenience

A construction contract can be terminated for cause or for convenience. A termination for cause occurs when one party stops work because of a deficiency in performance by the other party. Because the contract is terminated as a result of a party's own poor performance, the law provides the terminated party with little recourse in the event of a termination for cause. A termination for convenience, by contrast, occurs when the owner stops work for reasons other than a deficiency in performance by the contractor. Because a termination for convenience is not the result of poor performance by the contractor, the law provides the aggrieved contractor with significant rights against the breaching owner.

Termination for Cause

AIA Document A201-1997, Article 14.2.1 provides that the owner may terminate the contract for cause if the contractor fails to supply sufficient skilled workers or proper materials, fails to pay subcontractors or suppliers, persistently disregards laws and rules of a public authority, or otherwise substantially breaches the construction contract.

Article 14.1.1 provides that the contractor may terminate the contract for cause if, without the contractor's fault, work is stopped for a period of thirty consecutive days because of (1) the issuance of a stop work order by a public authority, (2) an act of government, (3) failure of the architect to issue a certificate for payment or failure of the owner to pay, or (4) failure of the owner to furnish the contractor with required information regarding financial arrangements for payment. Article 14.1.2 provides that the contractor may terminate the contract for cause if such a suspension exceeds more than 100 percent of the days scheduled for completion of the work or 120 days in any 365-day period, whichever is less.

Ohio law provides that if the construction contract contains a termination clause, specifying the conditions under which the contract may be terminated, the clause must be strictly followed, and no termination for other causes will be permitted.[44]

As in regular contract law, Ohio construction law provides that the party aggrieved by a material breach may recover the cost of repair from the breaching party, so as to protect his expectation interest in full performance.[45] Additionally, consequential damages will be available only if they were reasonably foreseeable at the time of contract formation.[46]

Termination for Convenience

A clause providing the owner with the right to terminate the contract for convenience is a common feature of public contracts.

AIA Document A201-1997 provides for either suspension or termination of the construction contract by the owner for convenience. Article 14.4 addresses termination by the owner for convenience, and provides that the owner may terminate the construction contract for convenience. However, Article 14.4.3 provides that, in the event of the owner's termination for convenience, the contractor is entitled to payment for work completed, costs incurred because of the termination, and reasonable overhead and profit on the work not completed.

Ohio law regarding termination for convenience demonstrates that such clauses are generally upheld. Persuasive authority from the U.S. Court of Claims has established that a termination for convenience is ineffective if the public owner acts in bad faith.[47] In *Refreshment Serv. Co., Inc. v. United States*,[48] the

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 6

dispute involved a concession contract in a public auditorium owned by the City of Cleveland. Invoking a termination for convenience clause, the City terminated the contract, and the concession company sued for wrongful termination. The Ohio Supreme Court held for the City, reasoning that a presumption of good faith attaches to a public entity's termination of a contract for convenience.

In *Daniel E. Terreri & Sons, Inc. v. Mahoning Cty. Bd. of Commissioners*,[49] the court upheld a ''termination for convenience'' clause in an action against county officials for breach of contract. In that case, the clause provided that the county had the right to terminate the contract without cause upon 10 days' written notice to the contractor. If it exercised that right, the county was bound to pay the contractor for the work already done, along with a proportion of the total contact price based upon the percentage of work that had been completed. Thus, Ohio law provides a contractor with significant rights when an owner terminates a contract for convenience.

Change Order/Changed Conditions

Change Orders

Generally, the architect or engineer may authorize only minor changes to a construction contract that do not increase the contract price or time; changes that increase the contract price require authorization by the owner. Change orders provide a mechanism for the owner to change the original plans or contract terms. A change order should include a description of the change, its affect on the contract price, and its affect on the time specified in the contract for performance. The construction contract will often include a changes clause, providing that valid change orders will be binding on the contractor. Agency concepts factor into whether a change order made by the architect is valid. Because only the owner has the power to issue a change order, only change orders deriving from that authority are valid. Generally, if the architect orders a change with the actual, apparent, or implied authority of the owner, that change order is valid. A changes clause should also encourage the contractor to recommend beneficial changes to the owner.

AIA Document A201-1997, Article 7.1.1 provides that a contract can be modified by change order, construction change directive, or minor change in the work. Under Article 7.2.1, a change order is a written instrument prepared by the architect, and signed by the architect, owner, and contractor, stating the change in the work and the adjustment to the contract price and time. Article 7.3.1 states that a construction change directive is a written order prepared by the architect, and signed by the architect and owner. The order directs a change in the work, so long as the change is within the general scope of the contract. The biggest difference between the change order and the construction change directive is that the latter is used when the parties are not in unanimous agreement regarding the change, as required for the change order. Under Article 7.4.1, the architect has the authority to order minor changes in the work that do not require adjustments to the contract price or time and are not inconsistent with the construction contract.

Change orders are valid under Ohio law, which permits contract modification with the mutual agreement of the parties.[50] Ohio law requires that new consideration support a contract modification.[51] Thus, if a change order modifies a contract so as to pay the contractor more for a project, the contractor must perform more or different work from that contemplated by the original contract.

Contract modification by change order, even when contemplated by a changes clause in the original contract, is limited. A contractor accepting a contract subject to a changes clause must abide by valid change orders. But if the ''change'' amounts to ''extra work,'' the scope of the original contract has been exceeded, and the contractor is under no obligation to agree to the contract modification unless the contract also contains an extra work clause. A ''change'' is work required in the performance of the original contract, without which performance cannot be had. ''Extra work'' arises independently of the contract and is not required for performance of the contract.

Changed Conditions

Another common clause in construction contracts is a changed conditions clause, which provides guidance in the event that there are unanticipated conditions at the construction site. A changed conditions clause generally provides that if the conditions materially differ from those indicated by the contract in such a way that increases construction costs, an equitable adjustment will be made to the contract.

AIA Document A201-1997, Article 4.3.4 is a widely used example of a changed conditions clause and provides:

> If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall so notify

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 7

> the Owner and Contractor in writing, stating the reasons. Claims by either party in opposition to such determination must be made within 21 days after the Architect has given notice of the decision. If the conditions encountered are materially different, the Contract Sum and Contract Time shall be equitably adjusted, but if the Owner and Contractor cannot agree on an adjustment in the Contract Sum or Contract Time, the adjustment shall be referred to the Architect for initial determination, subject to further proceedings pursuant to Paragraph 4.4.

As AIA Document A201-1997 demonstrates, changed conditions are typically divided into two categories. Type 1 conditions are subsurface or latent conditions that differ from those indicated in the contract. Type 2 conditions are unknown physical conditions of unusual nature that differ from those usually encountered in work similar to that specified in the contract.

Ohio law generally supports the contractor's ability to recover for costs incurred because of changed conditions. In *Condon-Cunningham, Inc. v. Day*,[52] the Cuyahoga County Court of Common Pleas held that a contractor could recover costs incurred because the subsurface conditions at the site were materially different from those represented in the plans and specifications.[53] Grounding its analysis in the warranty of sufficiency of plans and specifications, the court further held that the contractor's recovery was not prevented by the public owner's general disclaimer of liability for such errors in the contract or related documents.[54] However, the Supreme Court of Ohio has held that a contractor may not recover when the contract clearly and unambiguously shifts the risk of differing site conditions to the contractor and binds the contractor to make no claims regarding changed conditions.[55]

Pay if Paid, Pay When Paid Clauses

Because the contractor usually wishes to impose the same obligations on its subcontractors that it owes to the owner, flow-down clauses are common in construction subcontracts. Flow-down payment clauses include pay-when-paid and pay-if-paid clauses. In *Chapman Excavating Co., Inc. v. Fortney & Weygandt, Inc.,*[56] the court distinguished the pay-when-paid clause from the pay-if-paid clause:

> Under a ''pay-if-paid'' provision, the general contractor is required to pay a subcontractor only if the owner pays the general contractor; the risk of owner non-payment falls upon the subcontractor.... Under a ''pay-when-paid'' clause, however, a general contractor agrees to pay a subcontractor within a period of time after the general is paid by the owner, and the risk of owner non-payment falls upon the general contractor.[57]

Thus, it is imperative for the general contractor and subcontractors to be aware of whether a contract contains a pay-if-paid clause or a pay-when-paid clause.

Once one is aware of the distinction between the two types of clauses, it is relatively simple to determine which type is in the contract. A clause that provides that payment is due *if* the general contractor receives payment from the owner is a pay-if-paid clause, imposing no obligation on the general contractor until the owner makes payment. A clause that provides that payment is due *when* a certain performance is completed is a pay-when-paid clause, imposing the obligation to pay upon the general contactor within a specified or reasonable time. Further, in *North Market Assn., Inc. v. Case,*[58] a clause providing that payment is due if and when funds are available was held to be a pay-when-paid clause.

Ohio law generally permits both types of clauses, and many construction contracts include them. Ohio courts generally uphold pay-when-paid clauses so long as (1) they are unambiguous and (2) they explicitly state that payment by the owner is a condition precedent to payment of the subcontractor.[59] But if a clause functions to delay or deny contractors payment, the Ohio Revised Code permits contractors to take steps to protect their rights:

> No construction contract, agreement, or understanding that makes payment from a contractor to a subcontractor or materials supplier, or from a subcontractor to a materials supplier, lower tier subcontractor, or lower tier materials supplier contingent or conditioned upon receipt of payment from any other person shall prohibit a person from filing a claim to protect rights under sections 153.56, 1311.06, and 1311.26 of the Revised Code from expiring during the pendency of receipt of payment.[60]

Thus, for reasons of public policy, Ohio law does not favor clauses that function to deprive contractors of payment.

---

[1] http://www.aia.org.

[2] http://www.nspe.org/ejcdc/home.asp.

[3] http://www.agc.org/index.ww.

[4] AIA Document A201-1997: General Conditions of the Contract for Construction is the most widely-used model construction contract and is intended to be incorporated by reference into construction contracts. AIA Document A201-1997 is comprehensive in its coverage and is considered the foundational document for the rights and responsibilities of the parties to the construction contract.

[5] *Christe v. GMS Mgt. Co*., 124 Ohio App. 3d 84, 88, 705 N.E.2d 691, 693 (1997) (''[w]here one instrument incorporates another by reference, both must be read together'').

[6] *Krause v. Oscar Daniels Co*., 61 Ohio App. 337, 342, 22 N.E.2d 544, 547 (1939).

[7] *Carey Co. v. Riester & Thesmacher Co.*, 1934 WL 2569, 17 Ohio Law Abs. 547 (1934).

[8] *General Dynamics Corp. v. U. S*., 585 F.2d 457, 462 (Ct. Cl. 1978).

[9] *Tony Zumbo & Son Const. Co. v. Ohio Dept. of Transp*., 22 Ohio App.3d 141, 145, 490 N.E.2d 621, 626 (1984).

[10] *Danbert, Inc. v. Franklin County Engineer*, 2004 WL 451256, 2004-Ohio-1138 (2004).

@DOMINO/VENUS/PAMPHLET02/ATTORNEY/REFJ/ROSENBER SESS: 1 COMP: 08/16/07 PG. POS: 8

[11] *Lathrop Co. v. City of Toledo*, 5 Ohio St. 2d 165 (1966).

[12] *Associated Maintenance & Roofing Co., Inc. v. Rockwell*, 95 Ohio App. 3d 638, 643 N.E.2d 555 (1993).

[13] *Kelchner Excavating, Inc. v. Gene Zimmerman, Inc*., 25 Ohio Misc. 133, 264 N.E.2d 918 (1970).

[14] *Mason Tire & Rubber Co. v. Cummins-Blair Co*., 116 Ohio St. 554, 566-568, 157 N.E. 367, 371-72 (1927); *Valentine Concrete, Inc. v. Ohio Dept. of Adm. Serv*., 62 Ohio Misc.2d 591, 616, 609 N.E.2d 623, 639 (Ct. Cl. 1991); see generally, *Conti Corp. v. Ohio Dept. of Adm. Serv*., 90 Ohio App.3d 462, 466, 629 N.E.2d 1073, 1076 (1993).

[15] *Visintine & Co. v. New York, C. & St. L. R. Co*., 169 Ohio St. 505, 508, 160 N.E.2d 311, 313 (1959).

[16] R.C. 153.13.

[17] R.C. 4113.61.

[18] R.C. 4113.62 (A).

[19] Id.

[20] Id. at (B).

[21] Id. at (C)(1).

[22] Id. at (C)(2).

[23] Id. at (D)(1) & (2).

[24] *Carrabine Const. Co. v. Chrysler Realty Corp*., 25 Ohio St.3d 222, 228, 495 N.E.2d 952, 957 (1986).

[25] *Nix, Inc. v. Columbus*, 111 Ohio App. 133, 171 N.E.2d 197 (1959).

[26] R.C. 2305.31.

[27] *Brzeczeh v. Standard Oil Company*, 4 Ohio App. 3d 209 (1982).

[28] *Moore v. Dayton Power and Light Company*, 99 Ohio App. 3d 138 (1994).

[29] *Jones v. Stevens*, 112 Ohio St. 43, 146 N.E. 894 (1925), paragraph two of the syllabus.

[30] *In re Graham Square, Inc.*, 126 F.3d 823, 828 (6th Cir. 1997) (citation omitted).

[31] *Roger J. Au & Son, Inc. v. Northeast Ohio Regional Sewer Dist*., 29 Ohio App. 3d 284, 292, 504 N.E.2d 1209, 1216 (1986).

[32] *Dugan & Meyers Construction Co., Inc. v. State of Ohio Dept. of Administrative Services*, 162 Ohio App.3d 491, 834 N.E.2d 1 (2005).

[33] See generally, *Solomon Sturges & Co. v. Bank of Circleville*, 11 Ohio St. 153, 172 (1860) (finding an affirmation made at contract formation amounted to a warranty).

[34] *Mitchem v. Johnson*, 7 Ohio St.2d 66, 69, 218 N.E.2d 594, 597 (1966); *Velotta v. Leo Petronzio Landscaping, Inc*., 69 Ohio St.2d 376, 378, 433 N.E.2d 147, 149-50 (1998); *Floyd v. United Home Imp. Ctr., Inc*., 119 Ohio App.3d 716, 719, 696 N.E.2d 254, 256 (1997).

[35] *McMillan v. Brune-Harpenau-Torbeck Builders, Inc*., 8 Ohio St.3d 3, 4, 455 N.E.2d 1276, 1277-78 (1983).

[36] *Huber v. Bachman*, 12 Ohio Misc. 22, 25 (1967).

[37] *U.S. v. Spearin*, 248 U.S. 132, 39 S. Ct. 59 (1918).

[38] Id. at 136, 39 S. Ct. at 61.

[39] *Mason Tire & Rubber Co. v. Cummins-Blair Co*., 116 Ohio St. 554 (1927).

[40] *D.M. Sylvester & Dipaolo Construction Co. v. Village of North Randall*, 8 Ohio App. 2d 212 (1963).

[41] *Bates & Rogers Construction Co. v. Board of Commissioners of Cuyahoga County*, 274 F. 659 (N.D. Ohio 1920).

[42] *Valentine Concrete, Inc. v. Ohio Dept. of Adm. Serv.*, 62 Ohio Misc.2d 591, 609 N.E.2d 623 (Ct. Cl.1991).

[43] R.C. 1302.29 (B).

[44] *Au Rustproofing Center v. Gulf Oil Corp*, 755 F.2d 1231(6th Cir. 1985) (*held*, a termination was ineffective where it did not comply with the contract provision requiring ten days notice prior to termination).

[45] *Platner v. Herwald*, 20 Ohio App.3d 341, 342, 486 N.E.2d 202, 203 (1984).

[46] *R.H. Trucking, Inc. v. Occidental Fire and Casualty Co. of NC*, 2 Ohio App.3d 269, 272, 441 N.E.2d 816, 819 (1981).

[47] *See, National Factors, Inc. v. United States*, 204 Ct. Cl. 98, 492 F.2d 1383 (Ct. Cl. 1974).

[48] *Refreshment Serv. Co., Inc. v. United States*, 63 Ohio St. 2d 89 (1980).

[49] *Daniel E. Terreri & Sons, Inc. v. Mahoning Cty. Bd. of Commissioners*, 152 Ohio App. 3d 95, 786 N.E.2d 921 (2003).

[50] *Wallace v. Northern Ohio Traction & Light Co*., 57 Ohio App. 203, 13 N.E.2d 139 (1937).

[51] *Thurston v. Ludwig*, 6 Ohio St. 1, 6 (1856).

[52] *Condon-Cunningham, Inc. v. Day*, 22 Ohio Misc. 71, 258 N.E.2d 264 (1969).

[53] Id. paragraph 1 of syllabus.

[54] Id.

[55] *S & M Constructors, Inc. v. City of Columbus*, 70 Ohio St. 2d 69, 75, 434 N.E.2d 1349, 1353-54 (1982).

[56] *Chapman Excavating Co., Inc. v. Fortney & Weygandt, Inc.*, 2004 WL 1631118, 2004-Ohio-3867 (2004).

[57] Id. at ¶ 22.

[58] *North Market Assn., Inc. v. Case*, 99 Ohio App. 187, 132 N.E.2d 122 (1955).

[59] *Power and Pollution SVCS v. Suburban Piping*, 74 Ohio App.3d 89, 91, 598 N.E.2d 69, 71 (1991); *Thomas J. Dyer Company v. Bishop International Engineering Company*, 303 F.2d 655, 661 (6th Cir. 1962).

[60] R.C. 4113.62 (E).