Construction Law Newsletter

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Tax Reform Creates Fringe Benefits Problems For Contractors

Significant time and effort has been spent by commentators describing the pure income tax provisions of Tax Reform Act of 1986 (TRA '86) and the problems they have created for businesses of all types. Because of their subtlety, and in some cases their delayed implementation dates, certain changes in the fringe benefits provisions — especially as they relate to the construction industry — are less well understood. The purpose of this article is to alert construction companies, their counsel, and advisors of some of these problems.

RETIREMENT PLAN MINIMUM PARTICIPATION RULES

IRC §401(a) (26) is scheduled to go into effect on January 1, 1989. This code section generally provides that a retirement plan trust is not a tax qualified trust unless on each *day* of the plan year it covers either 50 or more employees of the employer or 40 percent of all employees of the employer. For purposes of the rule, an employer includes all employees of all the members of that employer's controlled group for federal income tax purposes as well as, assuming that the pending Technical Corrections Act passes, all affiliated service group and "leased" employees.

If the employer fails to satisfy the 50/40 rule on any day on or after January 1, 1989, the trust is disqualified and contributions to the trust by the employer are rendered non-deductible.

If an employer maintains more than one plan, each plan must separately pass the 50/40 test. In determining the percentage of employees covered by a plan, the employer may exclude employees covered by a pension plan created by a collective bargaining agreement. The employer may also exclude employees who are under 21 or have worked for the employer for less than one year unless the minimum age and service requirements of the plan are less restrictive than these standards.

An example will describe the adverse effects that the 50/40 rule can have on a construction contractor. Assume an open shop contractor with a salaried work force of ten persons. The company maintains a profit sharing plan for the benefit of these salaried people. The company also maintains a money purchase pension plan for the benefit of its field workers. This plan is approved by the Department of Labor for use on federal and federal aid projects subject to the Davis-Bacon Act and as such has no minimum age or time of service requirements. A test of the field worker plan compares the 100 people in that plan to the 110 person employee population. This plan satisfies both prongs of the test because it has both 50 covered employees and includes more than 40 percent of the total employee population. The salaried persons plan, however, fails both tests. Therefore, the salaried persons profit sharing trust is disqualified and contributions to that trust by the employer are not tax deductible.

Efforts are currently underway to change the taw to avoid the result described above. If such efforts are unavailing, significant plan design modifications will need to take place to avoid the results illustrated by this example.

DEFINED BENEFIT PLAN FULL FUNDING LIMITATIONS

TRA '86 provides that, at retirement, participants in a defined benefit pension plan can only take an annual distribution equal to their average compensation for their three top earning years. The most that a participant can receive in one year, however, is $90,000. The typical collective bargaining agreement includes a multi-employer defined benefit plan. According to a series of studies done by the AGC, about 3/4 of all construction industry multi-employer plans are now fully funded or over funded.

The Omnibus Budget Reconciliation Act of 1987 (OBRA) changed the full funding limitations on defined benefit plans to the excess, if any, of the lesser of 150 percent of the current liability or the total accrued liability under the plan For purposes of determining the current liability, OBRA requires the use of an interest rate that is plus or minus ten percent of an average federal bond rate. Using this rate, it is believed that virtually all construction industry multi-employer defined benefit plans will be found to be fully funded or over funded.

In such a situation, employer contributions to such plans are not deductible and, in addition, may be subject to a ten percent excise tax on all excess contributions. In other words, an Oregon union contractor which has taxable income at maximum state and federal rates would pay approximately $0.54 per dollar of pension contribution for all of its union workers! This despite the fact that construction employers are contractually bound to continue such payments to the plan. Unless this situation can be legislatively modified, the collective bargaining process or plan trustees must rescue contractors from this untenable position.

WELFARE PLAN NON-DISCRIMINATION RULES

Under prior law, virtually every type of fringe benefit plan was governed by its own set of non-discrimination rules relating to eligibility and benefits. TRA '86 set up a new set of rules for certain statutory fringe benefit plans and so-called cafeteria plans. Plans covered by the new rules include accident and health plans (both insured and self-insured) and employer group term life insurance plans. These rules are effective for plan years beginning after December 31, 1988 and may result in plan benefits being taxable to highly compensated employees.

In general, the rules prohibit discrimination in favor of "highly compensated" employees. The rules require that

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certain minimum standards be met for both eligibility to participate and the benefits provided. If the standards are not met, highly compensated employees will be deemed to have received taxable income with respect to the discriminatory excess benefits. In addition, the employer will he subject to substantial penalties should it fail to properly report the exccess benefits to the IRS. Particular problems are created by flexible benefit or cafeteria plans.

The following groups or classes of employees can be excluded from consideration in evaluating a plan under the new non-discrimination rules:

1. Employees who have not completed one year of service (except for certain basic benefits where a six month standard is applicable).
2. Employees who normally work fewer than 17% hours per week.
3. Employees who normally work less than six months during any year.
4. Employees younger than 21.
5. Employees covered by a collectively bargained plan.

The term "highly compensated employee" means those persons who at any time during the plan year:

a. were a 5% owner of the employer;

b. earned more than $75,000 in annual compensation from the employer;

c. earned more than $50,000 in annual compensation from the employer and were in the top 20% of the employer's work force on the basis of compensation; or

d. were officers of the employer and received compensation greater than 150% of the defined contribution dollar limit in effect for that year (for 1988 that limit is $30,000, so $45,000 is the threshold).

The tests for compliance are rather complex. The easiest test is one that requires that at least 80% of the employer's non-highly compensated employees be benefited. If this test is satisfied the plan does not discriminate for tax code purposes. If not, the plan may still qualify if it meets more complex eligibility testa involving analyses of benefits offered and received and percentages of highly and non-highly compensated employees. Such tests are beyond the scope of this article.

An example may make the tests more easy to understand. Assume an employer with 100 employees maintains a medical plan for the benefit of those employees. Assume that 30 of the employees are ineligible to participate because they do not meet the minimum age and service requirements. Of the 70 employees who are eligible assume that 10 are highly-compensated employees either through ownership or income.
This plan will not be labeled discriminatory because all of the non-highly compensated (100%) employees are covered.

Consider the same example, but assume that the plan requires contributions by employees and only 45 of them choose to contribute. The reasons for non-contribution may be shortage of income for this purpose, coverage by a spouse's plan, or coverage by a prior employer's plan. In this case the plan will be disqualified because only 75% of the non-highly compensated employees are covered.

If a plan discriminates in favor of highly compensated employees, the amount of the highly Compensated employees "excess benefit" will be included in those individual's gross income. In the case of health and accident and group term insurance the "excess benefit" is calculated in terms of the value of the coverage provided, rather than the premium paid. The IRS will provide tables to establish a value, but it is likely to be comparable to the premiums paid. The employer is required to report on the employee's **W-2** form the excess benefit or face a penalty of nondeductibility of all employer-provided benefits of the same type.

SUMMARY

Tax reform has created many surprises for the business community. If clarifications and modifications to the existing code are not made the construction industry will face significant costs and changes in the way it does business. Likely results will include: open shop contractors abandoning separate profit sharing plans for salaried or permanent employees; union shop contractors being forced to make non-deductible contributions to multiemployer defined benefit pension plans; and highly compensated employees being taxed on health and life insurance benefits if a portion of the rank and file choose not to contribute to welfare plans. Careful fringe benefit planning will be necessary to avoid these results.

Annual Report

Construction **Law** Section

The Construction Law Section presented a section mini-seminar on July 29, 1988 in Salem and has an "Ethics in Construction Law" seminar scheduled to coincide with the OSB Annual Meeting in Eugene.

The section also published issues of the Construction Law Newsletter, which is distributed to its members.

Members of the section are finishing chapters for the new Construction Law CLE handbook, which will be published by the bar. A major CLE presentation is planned in conjunction with the release of that manual.

During the year, the Executive Committee met and decided that due to the diverse interests represented in the section, it was not appropriate for the section to take any position regarding legislation. However, all legislation affecting the construction industry is closely monitored to enable section members and their clients to understand, affect and respond to legislative proposals.

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The 1987-88 year has been a succcess. The membership has expanded from **265** to **281** members. The section is continuing to increase its contribution to its members and the construction industry in general.

ANNUAL MEETING AGENDA

DATE: September **15, 1988** (Thursday)
TIME: Following completion of mini-seminar on ethics (Approximately 630 p.m.)
PLACE: Valley River Inn, Eugene, Oregon
South Columbia River

For more information contact: Michael J. Scott
(503) 620-4540

I. Call to order. Michael J. Scott.

II. Treasurer's report. Arnold L. Gray.

III. CLE update. Richard E. Alexander.
a) OSB Publication/Seminar
b) Mini-Seminars

IV. Legislation update. Charles R. Schrader.

V. Newsletter update. Richard E. Alexander.

VI. Report of the Chair. Michael J. Scott.

VII. Elections. Michael J. Scott.
(See Nominating Committee Report above)

VIII. Adjourn. Charles R. Schrader.

NOMINATING COMMITTEE REPORT

The following constitutes the report of the Nominating Committee of the OSB Construction Law Section. The members of the 1988-89 Nominating Committee are Cynthia Carter, G. Kevin Kiely, James Noteboom, and Charles R. Schrader.

In attempting to accomplish our task we found it difficult to get reliable information on the terms of office of current members of the Section Executive Committee. As you know, this became important this year as the new Model Section Bylaws establish different allowable terms of office than the Section's prior practices. We believe our information to be accurate, and request that the OSB be asked to upddate its records to reflect these findings.

Our reviews indicate that the following members have completed the first year of their two-year terms **as** Members-at-Large:

D. Michael Mills
Gary C. Peterson
Elizabeth Yeats

Donald A. Dole has resigned from his position. The Nominating Committee recommends that G. Kevin Kiely be appointed by the Executive Committee to fulfill the unexpired portion of the term of Mr. Dole **(1** year). This action should be taken at the next Section Executive Committee meeting, or the Section Executive Committee meeting scheduled for immediately after the Annual Meeting in Eugene, whichever first occurs. Also at that meeting, in light of the nominations below, we need to choose a new editor of the Newsletter. The announcement of the meeting should so state.

Traditionally persons elected to office positions in the Section advance in predetermined order "through the chairs" to Chair-Elect. The Nominating Committee recommends that this tradition continue, and nominates the following persons to the offices opposite their names:

Chair-Elect	William F. Cloran
Secretary:	Arnold L. Gray
Treasurer:	Ruth M. Spetter

In accordance with Section Bylaws, the current Chair-Elect, Charles R. Schrader, automatically succeeds to the office of Chair and will serve a term of one year.

The Nominating Committee nominates the following persons to serve two-year terms as Members-at-Large of the Section Executive Committee:

Richard E. Alexander
Frederick A. Batson (second consecutive term)
David T. Douthwaite
Jan D. Sokol

The Nominating Committee believes that it has used reasonable efforts to nominate members who reflect a reasonable cross-section of Section membership taking into account all relevant factors including, without limitation, the practice area, geographic, age, sexual, and racial makeup of the Section membership.

Editor's Note: Additional nominations may be made for any position from the floor at the Sections Annual Meeting. Elections for contested positions shall be by written ballot. Each contested position shall be voted upon separately.

Construction Contracts For The Project Owner:

I. INTRODUCTION

Often, the construction attorney is called upon to advise a client planning to construct an improvement as part of or following a real estate transaction. While the attorney's immediate focus is on the real estate transaction, an opportunity exists to render the client a valuable service by drawing attention to construction issues and, particularly, to the design and construction contracts **as** early as possible. The project Owner has considerable leverage in dictating contract terms governing its relationships with the Architect and the Contractor. Too often, this advantage is lost through inattention, leaving the task of determining the governing

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contract documents to the project architect.

The Architect will generally recommend standard printed American Institute of Architects forms and Supplemental Conditions. These forms have an inherent Architect bias and if the supplements recommended by the Architect have been prepared and reviewed by any attorney, generally it is the Architect's attorney. This is not to suggest that architects undercut the Owner's interest as a matter of practice, but only that if the Owner's attention is drawn to these issues early on, it can take advantage of its natural leverage to obtain contracts more beneficial and protective of its interests.

II. REPRESENTING THE PROJECT OWNER

A. Selection of Design Professionals and Construction Contractor.

The construction attorney's experience and contacts can be valuable to the Owner considering a substantial construction project. At least, the attorney can provide the names of potential architects, other consultants and contractors for consideration by the Owner. Owners sometimes involve the attorney in the evaluation and the selection process.

B. Determination of Project Structure.

The attorney should be involved in discussion of the appropriate contractual arrangements to be used, in tight of various factors involved in the project. Do time restraints justify taking the risk involved in "fast-tracking" the project, that is, commencing construction while design is still in progress? Should the project be done as a "turn-key" project, leaving both design and construction responsibilities to a single contracting entity? Should a process of competetive negotiation or competetive bidding be undertaken? Should such a process be opened to the industry at large or a select list of prequalified bidders? Should performance and payment bonds be required?

C. Negotiation of Design and Construction Contracts To Protect Owner's Interests.

The construction Owner should be assertive in the development of contract forms to govern design and construction of the project. It is the Owner's project. Generally, no one will be terribly surprised if the Owner insists that its attorney develop the first draft of contracts, or insists on terms which protect its interests. The attorney involved at this stage can coordinate and interlock the contract documents. The duties assumed by the Architect under the Owner/Architect Agreement should be consistent with statements relating to the Architect's duties in the Owner/Contractor Agreement. The dispute resolution provisions of the Agreements should be consistent and can be coordinated to increase the Owner's flexibility in tailoring the process to the particular dispute. Any special requirements imposed by land use regulations or project financing agreements should be coordinated with the terms of the design and construction agreements. Bonding and retainage requirements in the construction agreement must be considered for adequacy and compliance with statutory requirements.

III. STANDARD DOCUMENTS OF THE AMERICAN INSTITUTE OF ARCHITECTS

Much of the private commercial construction in the United States occurs under the standard agreement forms published by the American Institute of Architects ("AIA"), which is the national architects' association. The AIA expends considerable effort in the development and updating of these forms to meet the demands of a changing industry. The AIA sells the copyrighted forms and related materials. They may be obtained through the AIA's Portland office at 215 SW First Avenue, telephone: 223-8757.

Many of the AIA documents were substantially revised and reissued in mid-1987. The following selection of 1987 AIA forms will be discussed below:

"Standard Form of Agreement Between Owner and Architect," AIA Document B141;

"Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum," AIA Document A101;

"Standard Form of Agreement Between Owner and Contractor where the basis of payment is the Cost Of The Work Plus A Fee with or without a Guaranteed Maximum Price," AIA Document A111; and

"General Conditions of the Contract for Construction," AIA Document A201.

A. Benefits of Standard Documents.

The standard AIA documents are a great benefit to the industry. They provide a recognized standard for commercial construction throughout the country. They are a quick and easy means of documenting contractual relationships in the construction process. The documents have a long history and their provisions have been construed by courts in many jurisdictions, providing a level of predictability in their use.

B. Architects' Bias in Standard Documents.

The standard AIA documents have historically contained a natural bias for the interests of the Architect. While the documents' protection of the Architect is not always at the expense of the Owner, it must be considered in reviewing and modifying the documents for the Owner.

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C. Special Problems in **1987** Edition AIA Documents.

The 1987 Edition of the standard AIA documents significantly changed prior editions, in many cases to the detriment of the Owner. Issuance of these new documents last spring generated substantial critical commentary and it has **takensometimefortheindustry** to begintousethem. The national AIA has continued to urge their use and we are now seeing many commercial construction projects utilizing the new forms.

The new documents include the AIA's responses to liability exposure and insurance problems which have arisen in the last decade. The documents also reflect several contractor-oriented changes, apparently resulting from the involvement of the national Associated General Contractors ("AGC") in the document development process. It appears that several legislative-style compromises were achieved to obtain the AGC's endorsement of the documents. Changes beneficial to the Contractor are almost by definition unfavorable to the interests of the Owner and must be adjusted by Supplemental Provisions.

Some of the 1987 AIA documents exhibit an editorial sloppiness reflective of a rush *to* publication. Newly defined terms are not consistently applied and some language may have unintended consequences. In one case a bracketed editorial comment was incorporated in the printed document.

Still, these documents are therecognized standard and with careful review and adjustment on behalf of the Owner can result in a very workable project.

IV. ADJUSTMENT AND SUPPLEMENTATION OF AIA DOCUMENTS

The AIA documents contemplate modification to meet the particular requirements of the project. This is generally accomplished by striking through objectionable provisions of the standard forms and by attaching typed Supplemental Provisions. Each document should be carefully reviewed in light of the particular application proposed. Suitable revisions and supplements should be developed and carefully reviewed with the Owner before the proposed form of agreement is tendered to the Architect or Contractor. Often, the agreement is executed in the form proposed by the Owner, without significant revision. The discussion which follows is intended to assist the Owner's attorney in considering revisions and supplements to the A201 for protection of the Owner.

A. "Standard Form **of** Agreement Between Owner and Architect," AIA Document B141.

In reviewing the B141 for the Owner, one must keep in mind that it was developed by the AIA to protect its member architects. The Owner ordinarily has maximum leverage in determiningthe terms of this agreement as part of the final selection of the Architect. Too often, finalization of this agreement is left open, while the Architect proceeds with its work.

B141 Article 2 breaks the Architect's services into five phases. As well as programming and designing the project, the Architect is obligated to provide the Owner with revised estimates of Probable Construction Cost as the design is refined. The cost estimating should be directly addressed at the outset to assure that the Owner has adequate information tomakelater project decisions. If the Architect is not going to provide this service, alternate arrangements for estimating the cost of the work should be made.

Subparagraph 2.6.2 defines the Architect's project administration duties by reference *to* the most current edition of the AIA Document A201 General Conditions. Therefore, any special adjustments to the A201 bearing on the Architect's duties must also be addressed in this document. The final clause of Subparagraph 2.6.3 should be stricken. The Owner should not agree to make determinations regarding the Architect's role in the project subject to Contractor approval.

The balance of Article 2 should be carefully reviewed with the Owner *to* familiarize it with the Architect's duties on the project. Consideration should be given to the printed limitations on the Architect's involvement and exposure. The Owner may be able to negotiate more extensive Architect involvement. Given the Architect's supposedly neutral role in determining issues between the Owner and Contractor, the Owner should consider assigning an Owner's representative to monitor or inspect the work for the Owner. If the Owner's representatives will communicate directly with the Contractor, a suitable supplemental provision to Subparagraph 2.6.8 should be prepared.

In Subparagraphs 2.6.17 and 2.6.19, the Owner should consider whether it wishesto leaveissues ofaestheticeffect *to* the Architect's final decision.

B141 Article 3 defines services which, if rendered by the Architect, will entitle it to additional compensation. The Owner should be advised to carefully review the listed services and consider whether it might negotiate to have any included in the Basic Services. It is alsoimportantthat the Owner's employees who will be involved in the project understand the Owner's duties under Article 4.

Subparagraph 5.2.2 requires a supplemental provision, if a fixed limit of construction cost is contemplated.

B141 Article 6 vests ownership of the plans and specifications in the Architect. If the Owner wishesto have ownership, a supplemental provision is required. Architects are generally concerned that the plans may be reused on another project without payment of a fee and

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with possible additional liability for the Architect.

The B141 Article 7 arbitration provisions contemplate arbitration under the Construction Industry Rules of the American Arbitration Association ("AAA"). The Owner's attorney should consider modifying and supplementing this provision in several respects, including providing that the arbitration will not be subject to administration by the AAA. Administration of AAA arbitrations in Oregon is handled out of the Seattle AAA office. This can sometimes result in extended lines of communications between the parties and the arbitrators and other delays. In addition, the AAA charges an administration fee which is based on the dollar amount of the claims, not the service required to administer the case.

Arbitration by party selected arbitrators is often very workable. The supplemental provision can designate the presiding judge of the local Circuit Court to resolve any disagreements between the parties before the arbitrators are selected.

The Owner can sometimes obtain substantial flexibility in the form of the arbitration by a single arbitrator or a three-member panel, and by reserving the discretion to consolidate arbitration of disputes with the Architect with related disputes with the Contractor or others involved in the construction process. Subparagraph 7.3 of the printed B141 protects the Architect from consolidated arbitration and should be stricken. Without the right to consolidate, the Owner is exposed to the risk of inconsistent results in arbitration or litigation in multiple forums. The supplemented arbitration provision may also specify allowable discovery and grant the arbitrators authority to compel discovery and sanction parties for noncompliance. Construction disputes generally require some level of discovery. The supplemental provision can also specify hearing procedures and rules of evidence. It is important to coordinate the dispute resolution procedures in the B141 with those set forth in the Owner/Contractor Agreement.

In Paragraph 8.7, the printed provisions grant a windfall to the Architect in the event of termination and should be modified.

B141 Paragraph 9.1 can sometimes be a problem, if the Architect's place of business is not in the same state as the project. The AIA A201 General Conditions define the governing law as that of the state where the project is located.

B141 Paragraph 9.3 should be deleted. It purports to define the commencement of governing statutes of limitation at dates earlier than may otherwise govern. The printed provision can operate to deprive the Owner of a cause of action it might otherwise have, particualarly if there are latent defects resulting from errors and omissions in the Architect's work. Ordinarily the statute of limitation for negligence in connection with a latent defect will not commence until the date of discovery of the defect, with an ultimate statute of repose of ten years (ORS 12.135).

Paragraph 9.4 should be supplemented to make it ineffective if the terms of governing insurance policies prohibit such waivers of subrogation.

Other miscellaneous provisions which should be considered under B141 Article 9 include the Architect's indemnity of the Owner from liability arising from the Architect's work, a provision granting recovery of attorneys' fees to the prevailing party, a provision severing ineffective or illegal terms, a provision requiring the Architect to maintain designated levels of insurance, including professional liability insurance, and a provision requiring the Architect to redesign without charge corrections required by errors or omissions in the Architect's design.

Article 10 defines expenses for which the Architect is compensated on a reimbursable basis. The Owner may be able to negotiate to have some or all of these charges included in the fee for Basic Services.

B141 Subparagraph 10.5.1, "has been found liable" should be changed to "is liable."

B141 Article 11 sets forth the basis for the Architect's compensation. Paragraph 11.3 defines the basis for compensation of Additional Services, usually on an hourly rate basis. Subparagraph 11.3.3 defines the markup the Architect will take on work of its subconsultants. The Owner should seek to hold this as close to actual cost as possible and demand some justification of the Architect's markup of outside consultants. Similarly, the Owner should resist a markup on reimbursable costs under Subparagraph 11.4.1.

B. "Standard Form of Agreement Between Owner and Contractor where the basis of payment is a Stipulated Sum," AIA Document A101.

A101 is the basic agreement form for use on a fixed price contract. It is designed for use with the A201 General Conditions discussed below. The A201, as modified and with any Supplemental General Conditions, should be attached to A101 when it is executed. A101 is a fill in the blanks document, but does require some thoughtful attention to the Owner's requirements in its completion. The AIA publishes, as AIA Document A107, an abbreviated fixed price contract document for use on projects of limited scope. Generally, if a project involves a significant dollar value, the A101 and A201 documents should be modified for use on a fixed price contract.

The A101 Article 1 listing of contract documents should be complemented by specific enumeration of every document intended to become a part of the contract in A101 Article 9.

In earlier editions, A101 Article 2 served to specifically

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identify the scope of the work, by address, description of the project, including dimensions, size and special requirements. The new AIA document contemplates use of Article 2 only to list those items in the contract documents which are not to be constructed by the Contractor. The printed language can be adjusted to allow the project description to be included as in prior editions.

A101 Article 3 defines the Contract Time. The commencement of the contract time may be referenced to a particular date, or to the Owner's Notice to Proceed. Contract Time may be specified by reference to a specific date or to an elapsed number of calendar days. It is useful to identify not only the time for Substantial Completion, but also a specific date for Final Completion, to prevent the Contractor from dragging out the completion of "punch list" items for an inordinate period.

Article 3 may also be used to include a provision for liquidated damages. Often, the difficulty in requiring liquidated damages is in providing dollar amounts high enough to realistically compensate the Owner for delayed completion, without adversely impacting the bids. The AIA documents provide that time is of the essence. Therefore, without a liquidated damages provision, the Owner will have a damage remedy for delayed completion as a breach of contract. If special types of damages are contemplated as a result of delayed completion, they should be enumerated in Article 3 to avoid any issue of whether they were contemplated by the parties.

In A101 Article 4, the lump sum price is inserted in words and numbers. Any special breakdown used in establishing the lump sum or alternates used to establish the lump sum should be included in Paragraph 4.3 and, if unit prices are to govern, they should be included in Paragraph 4.3 with language stating that payment will be based on unit prices and actual quantities.

A101 Article 5 establishes the schedule for payment applications, and the percent of retainage from progress payments which the Owner will hold to assure completion of the work in accordance with the contract documents. Retainage is a common provision in construction contracts. The amount of retainage will vary from contract to contract, but generally does not exceed 10 percent. Where the Contractor provides a performance bond, ORS 701.420(1) limits the retainage which may be held to 5 percent.

Paragraph 7.2 allows insertion of an interest rate other than the legal rate to govern past due progress payments. Paragraph 7.3 provides space for other provisions affecting A101. Most supplemental provisions are better left for inclusion in the A201 Supplemental General Conditions.

C. "Standard Form of Agreement Between Owner and Contractor where the basis of payment is the Cost Of The Work Plus A Fee with or without a Guaranteed Maximum Price," AIA Document A111.

AIA Document A111 is commonly used to document construction of projects where some aspect of the project makes the cost plus reimbursable arrangement a more workable basis for administering the contract. Many Contractors would love to do all their work on a direct cost reimbursable basis with a fee for contract administration. This approach is often not to the Owner's advantage. On a fully cost reimbursable contract, the Contractor may not be motivated to do the work in the most cost efficient manner. However, if quality is an overriding consideration, the cost reimbursable format, with stringent design and contact administration control, may make sense. Most often, the Owner should require ultimate protection in the form of a Guaranteed Maximum Price ("GMP"), which is the total cost that the Owner will pay for the work specified at the time of contract execution. This price will be adjusted upward and downward as changes are ordered during the course of the work.

Many of the general comments above regarding use of the A101 apply as well to use of the A111. A111, as A101, is also designed for use with the A201 General Conditions. An abbreviated form of cost reimbursable contract with self contained General Conditions, is published by the AIA as AIA Document A117. While A117 might be considered for projects of relatively limited scope, on most commercial projects the A111 and A201 documents should be used.

A111 Article 3 demonstrates the impact the Associated General Contractors had on the 1987 editions of the AIA Documents. The last sentence imposes on the Owner superlative standards of performance which were not in prior editions and, in fact, are not included in the 1987 A101. The sentence should be deleted or revised to limit the Owner's undertaking.

In A111 Article 5, the basis for the Contractor's Fee is established. This may be a lump sum, but most often it will be a percentage of the Cost of the Work. The percentage fee arrangement is the easiest to use in pricing changes to the work. Subparagraph 5.2.1 establishes the GMP, which is the total of the reimbursable costs and the Contractor's Fee. The Contractor will absorb any costs it incurs beyond this amount, except to the extent the GMP is adjusted for changes to the work. If portions of the work are based on alternates or unit prices, they should be identified in Subparagraphs 5.2.2 and 5.2.3.

Articles 7 and 8 should be carefully reviewed with the Owner to assure that costs which are and are not reimbursable are clearly identified. In general, the A111 printed provisions fully reimburse the Contractor's direct costs and job site overhead. Costs of the Contractor's home

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office, including general and administrative expenses, are generally considered to be covered by the Contractor's Fee and are not reimbursable.

The A111 form, at Article 10, gives the Owner the right to be involved in the selection of subcontractors: If the Owner requires use of a subcontractor not used to establish the GMP, the Contractor will be entitled to a change order covering its increased cost to use the Owner's preferred subcontractor.

A111 Article 11 establishes the Owner's right to cost information to confirm that the payments made conform to the Contractor's actual costs. This provision may be supplemented to grant the right to review and copy the records throughout the project and to charge the cost of audit to the Contractor, if an overcharge is discovered. The right to audit is important, since progress payments on reimbursable cost contracts are generally based on the Architect's assessment of percentage complete applied to a schedule of values for items of work. Payments are not adjusted to actual cost until the end of the project.

It is important to note that the printed A111 Article 12, at Subparagraph 12.7.1 provides for retainage only from Contractor's Fee and not from the Cost of the Work. This is inadequate to serve the customary purpose of retainage, which is to provide an incentive for timely and proper completion of the work and a fund from which the Owner can remedy deficient work. This provision should be supplemented to require retainage from the full Contact Sum. Again, retainage may not exceed 5 percent of the Contract Amount, if the project is bonded.

At A111 Paragraph 15.1, the last clause should be stricken. In the event of termination, the Contractor's Fee should be based on work actually completed and not upon the full expected value of the contract.

Again, care should be taken to list every document intended to be part of the contract in A111 Article 16. Where possible the referenced documents should be attached as exhibits to the executed contract.

D. "General Conditions of the Contract for Construction," AIA Document A201.

AIA Document A201 is the standard form of General Conditions contemplated for use with either the A101 or A111 contact forms. This document, as modified, should be attached together with any Supplemental General Conditions to the executed contract form.

Article 1 sets forth some basic definitions and general requirements for the project. Revision of A201 Paragraph 1.3 must be coordianted with B141 Article 6, if the Owner wishes to retain ownership of the drawings and specifications.

A201 Article 2 defines the Owner's role and responsibilities. Subparagraph 2.1.2 requires the Owner to give the Contractor information required to perfect its construction lien. Subparagraph 2.2.1 requires the Owner to furnish evidence of project financing. This provision contains an odd parenthetical comment that seems to have been incorporated into the printed form from some reviser's notes.

The second seven-day notice loop of A201 Subparagraph 2.4.1 should be deleted. In this subparagraph, the term "Change Order" should be changed to "Construction Change Directive." The 1987 A201 establishes a new kind of change procedur, where there is not agreement between the Owner and the Contractor on the time or price adjustment required by a change. The new A201 form mixes the terms here, where there is unlikely to be agreement on the required adjustment. The requirement for Architect's approval should be stricken near the end of the subparagraph.

A201 Article 3 defines the Contractor's role. Subparagraph 3.5.1 should be supplemented to expressly state that the warranty is not limited by the Contractor's obligation to repair defects appearing within one year after Substantial Completion under A201 Paragraph 12.2. Subparagraph 3.11.1 again fails to list Construction Change Directive among the record documents which must be kept by the Contractor.

Subparagraph 3.18.1 should be deleted and replaced with a broad form Contractor indemnity of the Owner. The printed form only reaches liability for bodily injury, sickness, disease or death, or property damage other than damage to the work itself. The supplemental provision should exclude indemnity for loss caused solely by the negligence and wrongful act of the Owner, to meet the requirements of ORS 30.140. The Owner may find the broadened indemnity more palatable to the Contractor if the Architect, its consultants, agents and employees are removed from the indemnity.

A201 Article 4 sets forth the duties of the Architect and must be consistent with the Architect's obligations under the Owner/Architect Agreement. Subparagraph 4.1.2 should be revised to allow the Owner to adjust its relationship with the Architect upon notice to the Contractor. Both Subparagraphs 4.1.3 and 4.1.4 should be deleted and a supplement developed to provide that if the Owner terminates the Architect, it will see that the Architect's duties set forth in A201 will be performed by the Owner or another licensed architect. The disclaimers and protective provisions of the B141 are paralleled in the A201. If the Owner succeeds in requiring broader Architect involvement or liability, the revisions should be carried into the A201.

A201 Subparagraph 4.2.4 should be supplemented, if the Owner or a representative of the Owner will be engaging in regular communications with the Contractor. The gratuitous printed exemption from liability for the Architect should be deleted at the end of Subparagraph 4.2.12.

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The Owner's attorney should give careful consideration to the fairly complex dispute resolution process of Paragraphs 4.3 and 4.4. The printed form requires a formal claim submittal and consideration by the Architect as a condition precedent to the right to demand arbitration. Claims submitted to the Architect for initial determination include claims alleging an error or omission by the Architect. Claims must be made within 21 days of the occurrence giving rise to the claim.

Care must be taken that the Owner/Architect Agreement requires the Architect to carry out this claim review, without generating additional fees. On a complex claim or series of claims a considerable amount of analysis may be required of the Architect.

In A201 Subparagraph 4.3.2, the last clause should be deleted to avoid having the assertion of a mechanic's lien vitiate the entire claims process. A Supplemental Provision can be developed to confirm the Contractor's right to file a construction lien and to perfect it by the commencement of a foreclosure action, with the action being abated pending the outcome of the claims process, including arbitration.

A201 Subparagraph 4.3.6 provides the Contractor a remedy for concealed or unknown conditions at the site.

Subparagraph 4.4.3 should be supplemented to assure that inadvertent failure to take one of the specified actions within the relatively short period does not result in a waiver of the claim. The supplement should regard failure to communicate further to be a decision to stand on the claim as originally filed.

The discussion of the B141 arbitration provisions above is aplicable as well to the arbitration provisions of the A201. If joint arbitration of Owner/Architect and Owner/Contractor claims is provided, Subparagraph 4.5.5 should be deleted and care taken to assure that the provisions in the two agreements ar consistent.

A201 Subparagraph 4.5.6 requires all known claims to be asserted in the same arbitration. This applies as well to claims of the Owner. Care should be taken to assure that all known counterclaim issues are asserted against the Contractor.

A201 Article 5 deals with Subcontractors. Separate definitions are set forth in Paragraph 5.1 for Subcontractor and subsubcontractor. There is no definition of "supplier." The A201 document contains several statements of obligation or limitation of liability which refer only to "subcontractor." The Contractor may argue that the provisions do not apply to the work or activities of suppliers or subcontractors. To avoid this, a supplement should be developed to define "subcontractor" as used in the Agreement to include subcontractors and suppliers at every tier.

Subparagraph 5.3.1 should be modified to require subcontracts to be in writing. Additional supplements to Article 5 should be developed giving the Owner the right to pay by dual-payee check and requiring the Contractor to give Owner such information as may be required to facilitate such payments.

A201 Article 6 contains several provisions purporting to dictate the terms of contract the Owner will use in separate contracts for work on the same project. There is no reason for the Owner to make this kind of commitment to the Contractor. These provisions should be stricken. The last clause of Subparagraph 6.3.1 making the Owner's determination of the allocation of cleanup costs subject to the Architect's sense of justice also should be stricken. The Architect may not even be involved in the separate contracts. If the Contractor disagrees with the Owner's allocation, it may pursue the issue through the claims process and arbitration.

As mentioned above, Article 7 establishes a new mechanism to accomplish a change in the work, defined as a "Construction Change Directive." The Construction Change Change Directive is used where the Owner and Contractor do not agree on the time or price adjustment due as a result of a change. It allows the work to proceed despite such disagreement.

The requirement of the Architect's agreement to a Change Order should be stricken from A201 Subparagraph 7.1.2. If the Owner and the Contractor agree, it is irrelevant whether the Architect agrees. Similarly, the requirement that the change order be prepared by the Architect should be removed from Subparagraph 7.2.1, since the Owner might issue the Change Order directly. Subparagraph 7.3.1 should provide only that a Construction Change Directive is "by the Owner." The statement that this document is prepared by the Architect and that it is signed hy the Architect should be deleted. These suggested modifications do not eliminate the Architect from these functions, but eliminate any issue of validity if the Architect is not involved.

In Article 8, supplements can be developed to limit the Contractor's ability to claim damages occasioned by delay. If a no-damage-for-delay clause is employed, Subparagraph 8.3.3 should be deleted.

In A201 Article 9, which governs the payment process, Subparagraph 9.3.1.1 should be modified to expressly reserve to the Owner the right to withhold disputed amounts under Construction Change Directives. Subparagraph 9.6.3 should be modified to give the Owner, not the Architect, discretion to disclose prime contract payment information to subcontractors and suppliers. Subparagraph 9.10.3 should be supplemented to allow the Owner to retain twice the Architect's estimate of the amount required to complete the work.

Article 11 governs project insurance. It should be supplemented to specify the types and levels of coverage required. The Owner should be advised to seek its insurance broker's advice on appropriate coverage.

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Additional supplements should be considered requiring that the Owner be named as an additional insured on the Contractor's insurance and that the Contractor be responsible for any uninsured losses due to deductibles.

The Owner's attention should be drawn to Paragraph **11.3,** which requires the Owner to obtain the property insurance. The Owner should confirm with its insurance broker that this coverage is in place, before construction commences.

Subparagraphs 11.3.7, 11.3.9 and **11.3.10** state that the Owner is a fiduciary with respect to its handling of an insured loss, including insurance proceeds. This language was not in the prior edition A201. Whether or not the Owner is legally a fiduciary in this circumstance, the express statements to that effect as well as the requirement that the Owner furnish a bond in Subparagraph **11.3.9** should be stricken.

If performance and payment bonds are required from the Contractor, a supplement to Subparagraph **11.3.9** should be included. The provision should require separate bonds, rather than a single form performance and payment bond. The separate bonds can usually be obtained without additional premium.

Consideration should be given to limiting the bilateral consent to assignment clause of A201 Subparagraph 13.2.1 to the Contractor only. A supplement to Subparagraph **13.3.1** should specify the manner in which contractual notices are to be given and the names and addresses of persons who are to receive the notices.

Additional miscellaneous provisions for recovery of attorney's fees and severance of illegal or unenforceable terms can be added by supplement to Article **13.**

Paragraph **13.7** should be stricken. As discussed above for a similar provision in the printed B141, this provision purports to commence the statute of limitations for claims on dates earlier than might otherwise apply. This language may operate to deprive the Owner of a remedy it would otherwise have in some circumstances, particularly with regard to latent defects, where the limitation ordinarily would not commence until the discovery of the defect.

Article 14 governs termination. The Owner should consider whether it wishes to retain the right to terminate the contract for its own convenience, without cause.

A201 Subparagraph 14.1.2 should be redrafted to define what "proven loss" means as a part of Contractor's termination recovery. The measure of recovery should include payment for work completed plus overhead and profit on the work completed. The requirement the Architect certify the right to terminate in Subparagraph 14.2.2 should be stricken.

Subparagraph 14.2.4 is inappropriate for Guaranteed Maximum Price contract. It should be replaced with a provision limiting the Contractor to payment for the work actually performed in the event of termination, particularly where the termination is as a result of a Contractor default. The terminated Contractor should not have the benefit of its full fee or any shared savings, even if the project does not cost more as a result of the termination.

IV. CONCLUSION

The standard AIA Documents are a very valuable tool in facilitating economical documentation of the construction process on private commercial construction. However, they should not be used without careful review, modification and supplementation by experienced counsel to protect and enhance the Owner's interests.

John *F.* Bradach

Editor's Note: This article deals only generally with certain of the AIA forms and from an owner's perspective. The specific project will require even further revisions. General revisions of these documents from the perspective of the owner and architect and changes to other forms will be addressed in future issues.

"Where, Oh Where, Has My Little DAR Gone?"

Researching Federal Contracting Regulations

For the new practitioner finding the basic regulations that govern federal contracting can represent a substantial obstacle. Not only is there a bewildering maze of regulations but they keep changing the names of the darn things. The current regulation that governs federal contracting is the Federal Acquisition Regulation, FAR for short. It is published in several volumes and has **54** chapters known as "Parts". Each part covers a general subject area except for Part **52** which contains the clauses prescribed for use by other parts of the **FAR** in full text and tables of required and optional clauses. For each FAR clause there is at least one paragraph in Part 1 to Part 51 that says why the clause is used. The text of the clause itself is in Part **52.** FAR numbering is relatively simple, FAR 52.236-1 indicates that the reference is found in Part **52,** subpart **23,** paragraph **236** as the first alternate. Subpart titling is helpful but can generally be ignored.

Changes to the FAR are published from time to time. A FAR set must be "posted" to be current. Two systems of posting are commonly used. Minor changes are often hand written into the volumes until replacement pages are issued. Lengthy changes are either accumulated separately in some libraries or posted at the end of each part in others.

Unfortunately for the non-agency lawyer, each executive department, agency, and division has the ability to "supplement" the FAR. In the Department of Defense there is the Department of Defense Federal Acquisition Regulation Supplement known mercifully as DFARS

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which contains DOD guidance and implementation of the FAR. Additional policy can be found in a periodic publication called the Defense Acquisition Circular. Within DOD each service supplements the regulation further. The Air Force Supplement is known as AFFARS. You've probably guessed that means Air Force Federal Acquisition Regulation Supplement. the process continues downward through major command, to the operating agency level. Thus, there is an AFSCFAR Sup for Air Force Systems Command and so on.

There is a disconcerting habit on the part of the military to transmit "interim" message changes to thesupplements by electronic message (teletype). These changes are sometimes confirmed in printed form but sometimes are not. There is no reliable commercial publication source for these "messages". Only the agency will have them. Getting all of the regulations and guidance that bear upon a particular client's problem will often involve a trip to the library of the particular federal agency involved.

The FAR is thesuccessor of two prior similarly organized **sets** of federal regulations. First in time was the Armed Services Procurement Regulation (ASPR) and then the Defense Acquisition Regulation (DAR). Many FAR provisions and clauses have come unchanged from the ASPR through the DAR to the FAR. The vast majority of others have come with minor changes. FAR clauses in Part 52 list the antecedent clause by FAR, DAR or ASPR citation where the clause is unchanged. Not all material in ASPR and DAR was carried forward into the FAR. Some DAR provisions have continuing effect as guidance or as incorporated references. Some long term contracts are still governed by the DAR. Reconstruction to determine the precise law in effect at the time an older contractual agreement was entered into can be a formidable undertaking. Once again, a federal agency library will often be the only practical source for thereplacement pages and the effective dates of changes.

When ASPR and DAR provisions andclauses were taken over into the FAR there was extensive renumbering. Tables showing the renumbering have been published as part of the federal regulations themselves and are included in commercial republications like the CCH reporters. CCH, Westlaw and other research tools provide a means for tracking the history of FAR, DAR and ASPR provisions in the courts and before the boards of contract appeals. A combination of keyword searches and searches using present and past regulation numbers is necessary for a thorough job. Research of Comptroller General Decisions is tough. CCH and other commercial publications provide references to individual opinions through "B number" or published citation. Federal attorneys with access to the Air Force FLITE data base can get comprehensive keyword coverage of published and unpublished opinions and can locate a later opinion that refers to an earlier one by reference to the opinion number. Research of the opinions is otherwise a hit or miss proposition.

"Where, oh where, has the DAR gone?" Like the lost dog of the song it is out there if you know what to look for and where to look.

William F. Cloran

SECTION CLE

On July 31, 1988, the Construction Law Section conducted an Oregon State Bar CLE accredited program on "Arbitration Law". The speakers were Neal Blacker. Regional Administrationer for the American Arbitration Association, and Richard E. Alexander. The session was well attended. Written materials were distributed and, if anyone in the section is interested in receiving a copy, please notify Kevin Kiely.

The executive committee members of the O.S.B. Construction Law Section urge you to become an active member of the section. Educational program and newsletter reports will be part of the many benefits available to section members. All members of the Oregon State Bar Association are eligible ***...Join*** Today!

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