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**HIGH AND LOW TIDES: Practical Use and Impact of Incentive and  
Disincentive Clauses**

***(“Incentives and Disincentives in Construction Contracts  
With Some Focus on Smaller Projects”)***

**Jack O’Neil  
General Counsel  
Western Construction Group, Inc.**

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**Incentives and Disincentives in Construction Contracts**  
*With Some Focus on Smaller Projects*

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**General Counsel**  
**Western Construction Group, Inc.**

Finding incentives and disincentives in construction contracts requires some digging and some imagination. In the course of preparing for this paper and the program which it accompanies, research into cases and statutes was not particularly fruitful. What emerged was a view of the same contract terms we look at for other reasons in a slightly new light. In the end, looking for the incentive or disincentive aspects of many terms adds another dimension which can be useful in the drafting, discussion, and negotiation of particular contract provisions.

A look at the Index pages of some readily available treatises on construction law did not reveal any listings for “incentives” or “disincentives.” Therefore, some of what is discussed here is drawn from seventeen years experience as the general counsel for a specialty contractor. I have had many discussions with lawyers, and business people alike about why they “needed” a particular provision or why I was proposing a particular change. Often the reason is expressed as something to encourage the contractor to act in a certain way, or to refrain from certain practices. Such sources are hard to cite or footnote, even if I could recall all the names, and circumstances.

*Small Projects.* The subtitle is also there because I have not attempted to go too far beyond my own day to day experience. My work has been primarily with smaller projects, up to a few million in some cases, but often projects in the low six and even five figure range. Because many owners and contractors may contract for such projects on

“standard” forms, and rarely involve their lawyers until later when a dispute arises, there are some interesting reactions when the customer sees changes to their “standard” form proposed by some presumptuous in house lawyer. This is where some clues appear about what people view as incentives or disincentives. These reactions often come in the form of a reason for the provision expressed as a means to encourage or discourage certain practices or conduct. The main difference with larger deals is that there is more likely to be some exchange of ideas at the first draft or preliminary term sheet of a negotiated contract.

In the broadest sense many things in a contract are “incentives.” The incentive for the contractor to do the work is to receive payment. The incentive for the Owner to pay is to have the work done. But our question goes deeper than that. Which of the many terms and conditions are inserted by the drafters in order to encourage or discourage particular conduct by the other party. Many provisions are later discussed in terms of incentive or lack of incentive. These same terms are also there to preserve legal positions, shift risk, and to give one side or other the ability to more successfully argue a certain point. On the other hand certain provisions may be drafted as protection for the client, but in fact have incentive or disincentive tendencies without the drafter or user of the form realizing it. One way to protect from the consequences of perceived negative conduct or to increase the chances of perceived positive conduct is through incentives or disincentives. So, one may be inserting incentives without even realizing it.

**What is an incentive, or a disincentive?** Numerous contract provisions, while not labeled as such, may actually encourage or discourage certain behavior, conduct or practices in the course of a job. These provisions when examined in the context of the

concerns of the drafter have the appropriate characteristics. So, what are the definitions we need?

**Incentive**, according to a well known dictionary means: “Something, such as fear of punishment or the expectation of reward that induces action or motivates effort.”<sup>1</sup>

**Disincentive**, looked up in the same source showed “Something that prevents or discourages action; a deterrent.”<sup>2</sup>

So, not all incentives are positive rewards, they may be negative as well. One could say that an incentive can be either a “carrot,” and “stick.” The “stick is not necessarily a disincentive. The disincentive is something that discourages certain action usually because of the negative consequences, or to make the discussion come full circle, maybe just the loss of a reward. The stick incentive may be one that if not followed, takes away a benefit if the party does not act according to the requirements. We can all remember the loss of desert if we did not eat our vegetables.

Not all incentives are effective. When researching general indemnification provisions, you might run across a court that limits the enforcement of indemnification because if too much responsibility is shifted there is no incentive to run a safe job, or from the Owner’s perspective, provide a safe place to work. The risk of liability is but one type of incentive that can be so shifted to the other party as to be no incentive at all. Other real incentives for running a safe job is the avoidance of injuries which lead to loss of good workers, reduced productivity, workers compensation claims, OSHA citations, and a high experience modifier which hampers the contractor’s ability to bid on good

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<sup>1</sup>. American Heritage Dictionary of the English Language: Fourth Edition. 2000.

<sup>2</sup> Id.

work. The indemnification provision probably does not always play a big role in the decision.

**What to Look for.** The intent of the drafter is important to understand. Consider the particular conduct or practice to be regulated. What is the drafter really concerned about? These are the same questions we should be asking when entering into negotiations over those terms. However, the other party has to know the incentive is there if it is to have the desired effect. On larger jobs, where lawyers and experienced business people get involved to negotiate the many aspects of a construction project, one presumes this is common. When the other party sends the contract to a lawyer, the lawyer can ask the questions, about purposes, concerns, and possible alternatives. However, to understand that something is an incentive or disincentive you have to know it is there, and have some idea what it means. Many contracts are obviously written with the idea that no one reads them, and often they are in fact are not read. In this case the positive incentives may be overlooked and the negative incentives or disincentives are just traps. In such cases they may not have the result of influencing on the job behavior, only dispute resolution positions. All too often the non-drafting party does not look at the contract until a dispute arises which, of course, is too late.

**Lawyer's Role.** In many cases the lawyer's role in preparing the construction contract is in drafting a form which the client can use for various projects. These are then presented to a Contractor, Subcontractor or Owner as a "standard" contract. If a lawyer for the other side is engaged to review this, it is incumbent upon that lawyer to have some idea of the reason behind certain provisions. This helps the lawyer explain to his or her own client what the party who drafted the contract is concerned about, what risks are

imposed, or what conduct is being encouraged or discouraged. The client is then in a better position to make a more informed business decision about the risks assumed and the incentive opportunities. If the lawyers actually get the opportunity to discuss such things with each other, this understanding should make the negotiation more efficient.

**What conduct are you trying to encourage, or discourage?** Incentives are very closely related to risk allocation, so the provisions discussed are not new, just looked at in a different light. We should look at some contract terms that among their various intended functions have some aspect of incentive or disincentive.

**Incentives.** Some are carrots and some are sticks. The carrots are those which provide something positive in return for the conduct or result that is desired.

*Schedule Bonus for early completion.* This is probably the most obvious example of an incentive. It provides a cash bonus if the project is completed ahead of the agreed deadline. This can be a daily amount, or in other increments as seems appropriate. Projects with very critical time requirements may make use of this along with liquidated damages to provide the good with the bad. These provisions are reputed to be frequently used in highway construction contracts. The goal is to encourage good planning and attention to the details of scheduling. On the downside, an Owner may want to be careful not to provide such a good carrot, that the quality suffers from a few shortcuts to save days.<sup>3</sup> A sample bonus provision might read as follows: “Contractor will be entitled to receive a bonus of \$\_\_\_\_\_ for each day in advance of the scheduled completion date that substantial completion is reached, such bonus to be paid after final completion.” An

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<sup>3</sup> Alternative Clauses to Standard Construction Contracts, Second Edition Sec. 5.4., P. 115. Glower W. Jones, Aspen Law & Business 1998.

alternative would be to make the whole dependent on final completion, or issuance of a certificate of occupancy.

This provision is perhaps less common than its evil twin liquidated damages. Some contractors can relate stories of the puzzled or amused looks they received when they suggested this as a balance for liquidated damages. This may be reasonable in some circumstances but not all. If the Owner has financing and everything in place to begin operations in the new location at a certain time, finishing early may not be that much of an advantage, where finishing late would be a significant problem.

*Performance Bonus for exceeding performance criteria.* This provision may be used where the measure is not the completion time but certain performance criteria for a functional structure. Power plants may be a good example. The builders plan on a certain output, and efficiency. If the finished facility exceeds the goals, a bonus may be paid for each increment over the goal. The aim here is to encourage creativity, and diligence to make the result exceed expectations. As with any incentive, the target must be realistic and potentially achievable to be meaningful as an incentive, rather than just “pie in the sky”.

*Reduction in retainage at the half way point.* The withholding of retainage can be considered an incentive in itself encouraging the contractor to keep the project on schedule, and to reach final completion. However, it has become so prevalent in the industry that it may have lost some of the edge of an incentive, and is just a normal cost that contractors figure into the price. A positive way of encouraging timely performance without adding to cost by paying a bonus is to agree that if the project is on time, the retainage will be stopped or reduced at some milestone if things are on schedule, and

results are satisfactory. The halfway point seems to be the most common. This provides a cash flow incentive for the contractor to keep the project going on schedule. The owner will want to keep some discretionary control over the trigger of such change. In such case the inclusion of the phrase “may, in the Owner’s sole discretion, be reduced....” The trick is to find a balance between an incentive that is too automatic, and one that is illusory.

“Provided that Contractor has reached 50% complete within the scheduled time, and the work is satisfactory to Owner, Owner may, in its discretion, reduce the amount of retainage on subsequent payments from 10% to 5%.”

An alternative would be “...in its discretion eliminate any retainage from subsequent payments.”

Other retainage related issues that can provide some incentives for the Contractor include release of retainage for early subcontractors. Retainage is a significant financial drain on subcontractors who do early work on projects e.g. excavation, site work, foundations. If they have 10% of their revenue tied up in retainage for months or even years after their work is complete, it increases their cost, which goes into the price. If there is some assurance that the retainage will not be held so long, there is an incentive to reflect it in the price. Retainage is often not a part of the material supply on jobs, especially where the material is just purchased from market sources. Suppliers and Equipment rental companies resist retainage. If the Prime Contractor has to front the money for the additional 10% for long periods of time, it has an impact on the cost. One way to provide for this is to add the following:

“One hundred percent (100%) payment will be made on a line item basis within 60 days after substantial completion of the following line items: (a) excavation, (b) sheeting and shoring, (c) site utilities ....”<sup>4</sup>

A similar provision could be made for materials once delivered and properly secured at the site.

*Cost plus pricing with sharing of savings.* Cost plus pricing can work in a variety of ways. It is often used where there is some uncertainty in the design and conditions.<sup>5</sup> It can be set up as cost with a fixed fee, or cost with a percentage mark-up. It may be thought of as a cost control measure, but without a limit, it is an incentive to maximize cost. The fixed fee is less of an incentive to increase costs. A guaranteed maximum price or “GMP” can provide an incentive for the contractor to keep costs under control. If the GMP is exceeded, there is no more money, so the fee, or profit is eaten away. An incentive is created if the savings below the GMP are shared in some fashion. Without the sharing, the only incentive is to get as close as possible to the GMP without going over. An Example of such a provision is: “If the actual Cost of the Work and the Contractor’s Fee total less than the guaranteed maximum price, then the savings will be divided as follows: [\_\_\_\_ percent (\_\_\_\_%)] to the Owner, [\_\_\_\_percent (\_\_\_\_%)] to the Contractor.”<sup>6</sup> The GMP is often an item for the Contractor’s bid. But, if the work is not well defined there is no incentive to provide a GMP that does not have a lot of

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<sup>4</sup> Id., at Section 14.5, P.437

<sup>5</sup> Sec 9.2., Vol. 1, Page 253, Sweet on Construction Industry Contracts: Major AIA Documents, Justin Sweet, Jonathan J. Sweet - 3rd Edition.

<sup>6</sup> Alternative Clauses to Standard Construction Contracts, Second Edition Sec. 17.5, P. 476. Glower W. Jones, Aspen Law & Business 1998.

hedging in it. If the parties are flexible and somewhat creative, there may be room for adjustment if the scope evolves significantly.<sup>7</sup>

A related provision is the passing on of discounts. If the entire discount is required to be passed on, then there is little incentive to seek the discount. This is especially true when a cost plus pricing is used. In some contracts Owners have added a requirement that the Contractor seek all discounts and pass them on. This is an added financing burden because many discounts are tied to prompt (e.g. 10 days) payment. Unless the Owner is then going to accelerate payment, it just means the contractor has paid for material that much more in advance of the time when payment for that material will be received for the Owner.

*Value Engineering.* The contractor can sometimes suggest an alternative way to achieve a particular result at less cost. This so called “value engineering is another cost saving device. If the saving is not shared, there is little incentive to look for ways to do it cheaper especially with the increased risk if something does not quite work right. Like the cost plus, a sharing of the savings, provides some incentive for the contractor to look for these savings opportunities.

**Sticks.** These provisions vary only in that they are designed to encourage much of the same behavior, but in the opposite, more negative or more punitive way.

*Liquidated damages, for schedule.* This is probably the first thing that comes to mind when any list of incentives is made. It is a stick. If the work is not completed on time, the contractor agrees to pay as liquidated damages and not as a penalty, a specified

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<sup>7</sup> Id., at P. 477.

sum, usually expressed as a daily amount.<sup>8</sup> Courts do not like to enforce penalties, so such provisions will be scrutinized. The seventh circuit spoke of actual damages being hard to measure, so an amount is agreed to. It must also be reasonable in light of the anticipated or actual loss.<sup>9</sup> The obvious incentive is to encourage the contractor to complete the work within the time agreed to in the contract. A related incentive that may not be obvious is the incentive to more carefully prepare a schedule. It certainly behooves the contractor to carefully consider the overall time to complete the project as well as the schedule when considering a project where liquidated damages are part of the bargain.

The AIA standard forms do not contain a liquidated damage provision per se. There is a reference in the section on Contract Time that suggests that one can be inserted. The parenthetical also recognizes that a bonus for early completion may also be appropriate. “(Insert provisions, if any, for liquidated damages relating to failure to complete on time or for bonus payments for early completion of the Work.)”<sup>10</sup> This could pose problems in a competitive bidding situation, if a blank AIA-101 form is inserted in the bid package, without any specific mention of the desire for liquidated damages.<sup>11</sup> The Point is that Liquidated damages should be part of the bargain from the

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<sup>8</sup> The author has seen at least one case of hourly liquidated damages, where the structure a busy bridge over a body of water is worked on in off hours and must be up and running by 6:00 am each day.

<sup>9</sup> *Energy Plus Consulting v. Illinois Fuel Co.*, 371 F3d. 907 (7<sup>th</sup> Cir. 2004). In this case, the court found a excessive penalty which called for lump sum for any breach no matter how minor.

<sup>10</sup> Section 3.3., AIA Document A101 – 1997 Edition.

<sup>11</sup> Sec 16.11., Vol. 2, Page 111, Sweet on Construction Industry Contracts: Major AIA Documents, Justin Sweet, Jonathan J. Sweet - 3rd Edition.

beginning, not just thrown in when the final contract is prepared. The EJCDC contract forms do provide a liquidated damage provision in the form. The only blank is the dollar amount.<sup>12</sup> The 1990 version of the contract had a very comprehensive treatment of the language usually found in Liquidated damage provisions.<sup>13</sup>

Sometimes it seems liquidated damages are inserted to show that “we mean business on this schedule.” If actual damages can be determined, the Owner may want to leave that option open. Liquidated damages can be a limit on recovery in case of serious delays in completion. One downside incentive may occur when the cost to meet the schedule exceeds the liquidated damage amount causing the contractor to favor the less expensive option. This might be curiously called a “positive disincentive.”<sup>14</sup> This provides some incentive for the Owner to use a reasonable number in adding liquidated damages to the contract. If it is too high, it may not be enforceable. If it is too low, it may not have the intended incentive clout.

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<sup>12</sup> Id., at Page 110.

<sup>13</sup> Paragraph 3.2, Standard form of Agreement Between Owner and Contractor on the Basis of A stipulated Sum, (No. 1910-08) (1990 Edition) reads as follows:

3.2 *Liquidated Damages.* OWNER and CONTRACTOR recognize that time is of the essence of this Agreement and that OWNER will suffer financial loss if the Work is not completed within the times specified in paragraph 3.1 above, plus any extensions thereof allowed in accordance with Article 12 of the General Conditions. They also recognize the delays, expense and difficulties involved in proving the actual loss suffered by OWNER if the Work is not completed on time. Accordingly, instead of requiring any such proof, OWNER and CONTRACTOR agree that as liquidated damages for delay (but not as a penalty) CONTRACTOR shall pay OWNER \_\_\_\_\_ dollars (\$ \_\_\_\_\_ ) for each day that expires after the time specified in paragraph 3.1 for Substantial Completion until the Work is substantially complete. After Substantial Completion, if CONTRACTOR shall neglect, refuse or fail to complete the remaining Work within the time specified in paragraph 3.1 for completion and readiness for final payment or any proper extension thereof granted by OWNER, CONTRACTOR shall pay OWNER \_\_\_\_\_ dollars (\$ \_\_\_\_\_ ) for each day that expires after the time specified in paragraph 3.1 for completion and readiness for final payment.

<sup>14</sup> 2 Brunner & O'Connor Construction Law Sec. 5:20, [FN 10], Thomson West, 2007.

*Liquidated damages for shortfall in performance criteria.* The same approach can be used to encourage maximum effort to achieve performance goals. It may be harder to calculate the proper number because the shortfall may be a permanent shortfall in usefulness, rather than the more temporary damage caused by late completion. The main criteria would seem to be a reasonable standard against which to measure performance. It should be achievable, or it becomes a vehicle for a discount more than an incentive. If a contractor senses this, they may build the discount into the price, in which case, any incentive value is lost. A persistent question here, more perhaps than in schedule related damages, is the argument that it is the design, and not the contractor performance that is the cause of the shortfall. This is a topic for a more in depth treatment than called for in this survey.

*Withholding of payment.* Most contracts have a laundry list of reasons for withholding payment. Some may encourage certain conduct; some are more just a means for protection of the Owner when a project starts down the road to problems. Some like failing to have enough men and material are subjective standards which can lead to separate disputes about whether they are properly applied. This raises a number of questions. Does the threat of withheld payment really provide an incentive for the contractor to add manpower to the job? What is the proper amount of manpower to do the job? Having disclaimed any responsibility for means and methods, are either the owner or design professional really in a better position to know this? The main consequence of the problem with inadequate staffing is timely completion. There are more direct ways to encourage the adequate staffing that results in timely completion. Since payment should be based on the amount of the work performed, then slower pace is

going to reduce the progress payments. Careful attention to the progress payments may prove more effective than arbitrary withholding based on judgments about the level of manpower on the job. It is often the role of the design professional to certify amounts completed for payment.<sup>15</sup> If this process is working correctly, it is the amount of work done, rather than the staffing that should affect the payment.

Another reason for withholding is some indication that there is not enough left in the contract price to cover the cost of completion. This whole subject is one that owners and contractors can debate at some length. But as for an incentive, it may be effective to avoid heavily front loaded billing. However, such practices may only lead to disputes on the first invoice.

**Disincentives.** Provisions to discourage or deter certain action or activity. Disincentives, even more than incentives, can just be traps or “gotchas” if the party against whom they are to be enforced does not appreciate the disincentive message, or even worse, does not even know the provision is there. Often disincentives come in the form of remedial measures that are agreed to in the contract, and can be exercised without a judgment of breach against the other party. They are useful as some more immediate consequence is included to make the deterrent more effective. However, some provisions may also provide such a lack of incentive for conduct that the drafter wants to encourage, as to be of little value.

*Pricing and payment.* Cost plus pricing without a share of the savings. As discussed above, cost plus type contracts can and often do award the contractor a share of

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<sup>15</sup> Sec. 9.4 General Conditions of the Contract for Construction, AIA Document A-201 – 1997 edition.

the savings using an agreed formula.<sup>16</sup> However, if there is no sharing of the savings, there no financial incentive to seek such savings. Furthermore, if the “plus” is a percentage mark-up, the loss of the mark-up on the costs that are saved is not going to encourage anyone to seek out cost savings. Thus, it can actually be a deterrent to seeking the cost savings. This is likely an unintended result, but it is there just the same. One way to change the impact of this disincentive is to use a fixed fee rather than a mark-up, so that the cost savings do not cut into the fee. So when preparing a pricing provision like this the drafter needs to consider what the contractor’s reaction is likely to be?

*Value Engineering, no share of savings.* Similarly, if the Contractor is asked to look for ways to cut costs by making adjustments in the original design, and there is no sharing of savings, it is a deterrent due to the increased risk that is taken on by getting into the design function.

*Changes.* At first look, the disincentive aspects of change order rules may not be apparent. One reason to have tight controls is to protect against late claims for changes or claims that things were changed by oral direction. But beyond the defensive measures, is a message to the contractor and the subcontractors not to be looking for changes on this job, because we are not going to pay, unless you do it exactly right. The careful contractor can find these rules and, assuming they are realistic and reasonable, set up its project management to deal with them. The Owner can use them to keep costs under control. But, both parties must know what they are, and follow the agreement to live by them.

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<sup>16</sup> Sec 9.2., Vol. 1, Page 253, Sweet on Construction Industry Contracts: Major AIA Documents, Justin Sweet, Jonathan J. Sweet - 3rd Edition.

*No changes paid for unless written approval first.* This discourages claims for changes and extras after the work has been done. Certainly this is a defense to late claims, but when it is a known condition, it has the additional effect of deterring such claims. This can lead to conflict when the owner's on site representative does not recognize that changes must be directed in writing. Jobsite harmony can be disrupted if the contractor reminds the owner that they made that rule, and should live by it also. A strain on working relationships can also result when the owner's representative makes an oral request then later insists that the contractor has waived the claim because it did the work without written authorization. The EJDC form states it as follows: "CONTRACTOR shall not be entitled to an increase in the Contract Price or Contract Time with respect to any work performed that is not required by the Contract Documents as amended, modified or supplemented as provided in paragraph 3.04...."<sup>17</sup> A reference to paragraph 3.04 includes a "Work Change Directive" which suggest that a final Change Order is not necessary. Some less exacting contracts just make reference to "written authorization". The message is clear, however, if you don't do it right, don't bother coming in and asking for change order payments at the end of the job. The requirement for a written authorization is in one sense a disincentive for conduct that should be discouraged, but it is also a good rule to have for both parties, so as to eliminate disputes.

*Short time limits to get claims in coupled with a waiver.* Such provisions do discourage asserting claims late in the project to increase revenue or make up for losses. However, such time limits should be reasonable and realistic. Some of these limits are as

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<sup>17</sup> Paragraph 10.02, Standard General Conditions of the Construction Contract (No. 1910-08) (1996 Edition).

short as 24 hours, while more reasonable ones are 7-21 days.<sup>18</sup> Among the longest ones noted are the EJCDC's 30 day requirement for initial notice, and the 60 day deadline for final documented claims.<sup>19</sup> The 24 hour requirement is both unrealistic, and unreasonable. This time can evaporate over a weekend. One wonders how the owner is prejudiced if the claim comes in 5 days after the "event" which causes the claim instead of 24 hours. The deterrent effect on late claims is still there.

*Back charge for cost of A/E responding to inquiries.* This is a deterrent to asking unnecessary questions, or using the inquiries as a means to fish for extras. It might also be an incentive to ask as many questions as you can up front, before the extra charges start. If used incorrectly, or too much, it is a deterrent to questions altogether, and may be a deterrent to some useful dialogue between the contractor and the design professional.

*Broad representations coupled with waivers.* Discourages claims for supposedly unanticipated conditions. This can be thought of as the "you should have known" provision. The representations and warranties should be reasonable, and consistent with the actual opportunity to inspect the site. This is a deterrent to making claims for unanticipated conditions where the contractor knows that the response will be to remind the contractor of the representations made in the contract, and the accompanying waiver.

All of these change-related items have some disincentive qualities to them, and if taken together should also encourage careful change order management.

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<sup>18</sup> AIA form A-201 allows 21 days. Still within one normal monthly pay period, but still long enough to allow reasoned estimates and pricing.

<sup>19</sup> Paragraph 10.05.A, Standard General Conditions of the Construction Contract (No. 1910-08) (1996 Edition).

*No damage for delay.* These provisions not only discourage, but probably eliminate delay claims. Such provisions often read something like the following: “Under no circumstances shall contractor be entitled to any increase in the Contract price, or any damages on account of any delay in the progress of the work. Contractors sole remedy shall be an increase in the Contract Time commensurate with the delay, except if the delay is caused by the fault of Contractor.”<sup>20</sup> The subject of weather delays is sometimes dealt with in detail by providing a chart for the normal number of adverse weather days in each month of the year, and extensions will only be granted if the number of actual weather days exceeds the stated amount. The Owner wants to encourage the contractor to evaluate the project for the potential for delay, and build in some provisions for specific situations peculiar to that project or allow for some of it in the proposed schedule. One issue encountered on restoration projects on existing buildings may be noise. All parties should understand what noise is likely and what the consequences will be if requested shut downs are requested due to noise. This can be the subject of a special stipulation without eliminating the general “no damage for delay” provision.

*Claim Procedures.* While the claim procedures have other reasons to be in the contract, some disincentive purposes can be seen.

*Forum selection not at place where project is located.* One wonders why in a construction contract, the forum for dispute resolution should be anywhere except the forum where the project is located. However, some parties insist that all disputes must be in the county where their corporate office is located. Presumably this discourages all but the most significant litigation, if the other party must go to a city distant from the project,

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<sup>20</sup> This language is a composite of numerous such clauses encountered in the course of contract review by the author.

and retain a local lawyer to pursue a claim. Another reason may be to get all claims in the same place, so that they can be handled by the law firm of choice. This is complicated when mechanics liens are involved, because it may be difficult to enforce a Minnesota mechanics lien in Texas. When arbitration is involved, it will probably require an additional proceeding.

*Attorneys fees provisions.* One of the first questions asked by clients is whether they can collect attorney's fees if they "win." One sided attorneys fees provisions are sometimes encountered. Why pursue a claim if you can't collect attorney's fees, but the other side can. One reason to write them that way is to discourage the other party from resorting to litigation. However, at least one state has a policy against enforcing attorney's fees provisions at all, unless the court determines that the action was frivolous or brought in bad faith.<sup>21</sup>

*Prevailing party Definition.* Many contracts have a prevailing party provision for recovery of attorney's fees and costs in litigation or arbitration. But often the question of just who is the prevailing party is just as difficult to resolve as the underlying dispute. Some provisions now provide some guidelines for what is a "prevailing party." The general idea is that one who sues for \$100,000 and recovers only \$10,000 is really not the prevailing party, and should not recover attorneys fees. If drafted carefully this should be a deterrent to questionable or frivolous claims. Therefore, some creative adjustment of the traditional prevailing party agreement not only helps bring some order to the definition of prevailing party, it may offer some incentive to try and settle the matter.

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<sup>21</sup> Neb. Rev. St. § 25-824.

*Termination for Convenience.* Here is a provision that if misused can provide an incentive for bid shopping after the contract is signed, or provide an out on a project when disputes arise. To balance this, there should be some cost for such action. The AIA forms provide that the contractor “shall be entitled to receive payment for Work executed, and costs incurred by reason of termination, along with a reasonable overhead and profit on the Work not executed.”<sup>22</sup> Many contracts leave out all but the payment for the work executed. The inclusion of termination costs, and overhead and profit on the cancelled work, serves as a disincentive for an owner to use the termination for convenience provision too lightly.

A variation on the termination for convenience, which shows up occasionally is the provision that payment for work done will be based on a cost plus a small mark-up. This is without regard to what the pricing of the underlying contract is. In some cases, it could give the owner a significantly better price than completion. Is this an incentive to terminate for convenience? Probably not, but it does raise a question.

*Partnering.* Partnering is not really a contract term, although some contracts require the contractor and other parties to participate. It is not a project delivery method, but if seriously undertaken can provide incentives for the parties to a construction contract to find mutual objectives, enter into cooperative decision making, and use feedback to improve joint objectives.<sup>23</sup> It is an attempt to change the adversarial nature that exist on some construction projects, and the view that one can gain only at another’s

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<sup>22</sup> Sec. 14.4.3. General Conditions of the Contract for Construction, AIA Document A-201 – 1997 edition.

<sup>23</sup> 2 Brunner & O’Connor Construction Law Sec. 6.17, Thomson West, 2007.

expense. The incentive to participate is that it may avoid disputes, or make them easier to resolve later on. A smoother running project should be an incentive to participate.

**Dealing with provisions that have incentives and disincentives.** These kinds of terms are encountered in most construction contracts, but in a wide variety of levels of reasonableness. Approaching the negotiation over particular terms one should explore the incentive, disincentive questions, as well as the question of what the other party is concerned about. If a question is posed in those terms, it may surprise the person on the other side, even if that person is a lawyer. Ask if this provision is written the way it is just to remove an issue or shift a risk, or are they trying to create an incentive for a certain behavior by your client?

*Is there overkill?* This may give you two ways to deal with the overkill that creeps in to many contracts, as lawyers try to draft around real or perceived problems. You may be able to draft an alternative, that still contains an incentive in the right direction without going so far as to kill any incentive to want to enter into the contract. The consideration of incentives or disincentives is a second avenue to compromise.

*Can a compromise be proposed?* If the real reason for a provision is to provide some incentive for the other party, perhaps something less than the all out waiver of rights is sufficient to create that incentive. Another possibility is to look for other incentives that balance the lowering of the provision in question.

*Can you live with it if you understand it?* When crossing the street, it is the car you don't see that hits you. In contracts, it is the term you haven't looked at that nails you in the final closeout of the project. So, when you look at contracts for your clients, think about what incentive is created, or perhaps squelched by this provision. If it is

known, perhaps the client can live with it. Ask them what they can handle, don't just tell them "you have to have this." When drafting contract provisions, remember that carrots should be attainable, and sticks avoidable if they are to be effective.