

# UNDER CONSTRUCTION

## PITFALLS IN COST-PLUS CONTRACTS

By Steve Holloway

**A**IA Documents A111 and A131/CMc are ostensibly the two most popular standard form contracts used on construction projects where the basis of payment to the contractor is the cost of the work plus a fee. These AIA contract forms contain provisions that arguably could support a finding of a fiduciary duty on the part of the contractor. These provisions include:

- *The contractor accepts a relationship of trust and confidence.*
- *The contractor covenants with the owner to cooperate with the architect and exercise the contractor's best skill and judgment in furthering the interests of the owner.*
- *The contractor agrees to furnish efficient business administration and supervision.*
- *The contractor agrees to perform the work in an expeditious and economical manner consistent with the interests of the owner.*

A fiduciary relationship carries a duty of good faith and loyalty and the obligation to make full disclosure of all known information that is significant and material to the affairs of the party reposing the trust. Such duty also can be imposed if the relationship is one where one of the parties is in a position to dominate the other party. In situations where the general contractor is experienced in construction cost-plus contracting and the owner is rarely in the construction market, one could argue that the contractor is in a dominant position. Such a relationship, together with the above provisions in a contract, would

further support the position that a contractor has a fiduciary duty to the owner. Nevertheless, courts generally have found that a general contractor does not have a fiduciary duty to the owner. See *Eastover Ridge, L.L.C. v. Metric Const., Inc.*, 553 S.E.2d 827 (N.C. App. 2000); *Avon Bros., Inc v. Tom Martin Const. Co.*, Docket Nos. A-740-99T1, A812-99T1, A-1681-99T1 (N.J. App. Div. Aug. 2000) (unreported). But see *Jones v. J. H. Hiser Const. Co.*, 484 A.2d 302 (Md. Spec. App. 1984) (the contractor had a duty to be aware of the ongoing or escalating costs of construction and to communicate this information to the plaintiff in timely fashion).

(continued on page 4)

### REPORT OF THE NOMINATING COMMITTEE

In accordance with Section 6.4 of the Forum Bylaws, the Chair announces the following nominees for office in 2003-2004, to be elected at the Annual Meeting of the Forum in Boston, Massachusetts on May 9, 2003:

**For CHAIR (automatic):**  
**John R. Heisse II**  
**San Francisco, CA**

**For CHAIR-ELECT:**  
**James Duffy O'Connor**  
**Minneapolis, MN**

**For GOVERNING COMMITTEE MEMBERS-At-Large (3-year term):**  
**D. Robert Beaumont, Toronto, Ontario**  
**Robert J. MacPherson, New York, NY**  
**Mark J. Heley, Minneapolis, MN**

### IN THIS ISSUE

Message from  
the Chair-Elect . . . . 2

In Memoriam: Ralph  
L. Kaskell, Jr. . . . . 3

Cornerstone Award . 3

Announcement  
Corner . . . . . 6

Next Forum  
Meeting . . . . . 8



## UNDERCONSTRUCTION

The newsletter of the ABA Forum  
on the Construction Industry

Vol. 5, No. 2 • March 2003

### Newsletter Editor

Cathleen S. Bumb

The Premcor Refining Group Inc.

8182 Maryland, Ste. 600

Clayton, MO

314/854-9829

fax 314/854-1455

[cathy.bumb@premc.com](mailto:cathy.bumb@premc.com)

### 2002-2003

## OFFICERS AND GOVERNING COMMITTEE

### CHAIR

Deborah S. Ballati

415/954-4400

[dballati@fbm.com](mailto:dballati@fbm.com)

### CHAIR-ELECT

John R. Heisse II

415/371-1200

[jrheisse@thelenreid.com](mailto:jrheisse@thelenreid.com)

### IMMEDIATE PAST CHAIR

C. Allen Gibson, Jr.

843/720-4613

[agibson@bmsmlaw.com](mailto:agibson@bmsmlaw.com)

### GOVERNING COMMITTEE MEMBERS

Lynn R. Axelroth

215/864-8707

[axelroth@ballardspahr.com](mailto:axelroth@ballardspahr.com)

Douglas C. Green

651/699-2037

[dglakeside@attbic.com](mailto:dglakeside@attbic.com)

Kimberly A. Hurtado

262/783-1705

[khurtado@hurtadosc.com](mailto:khurtado@hurtadosc.com)

Kenneth R. Kupchak

808/531-8031

[krk@hawaiiattorney.com](mailto:krk@hawaiiattorney.com)

Ty D. Laurie

312/258-5511

[tlaurie@schiffhardin.com](mailto:tlaurie@schiffhardin.com)

W. Alexander Moseley

251/694-6291

[alecm@handarendall.com](mailto:alecm@handarendall.com)

Douglas S. Oles

206/623-3427

[oles@oles.com](mailto:oles@oles.com)

Michael D. Tarullo

614/462-2304

[mtarullo@szd.com](mailto:mtarullo@szd.com)

Fred D. Wilshusen

214/369-3008

[fwilshusen@tfandw.com](mailto:fwilshusen@tfandw.com)

*Under Construction* is published by the American Bar Association Forum on the Construction Industry, 750 North Lake Shore Drive, Chicago, IL 60611. Requests for permission to reprint and manuscripts submitted for consideration should be sent to the attention of the Editor, Cathleen S. Bumb. Address corrections should be sent to the ABA Service Center at the address above.

The opinions expressed in the articles presented in *Under Construction* are those of the authors and shall not be construed to represent the policies of the American Bar Association or the Forum on the Construction Industry. Copyright ©2003 American Bar Association



## MESSAGE FROM THE

# CHAIR

John R. Heisse II,  
Chair-Elect

## ELECT



In the San Francisco Bay Area, where I practice, we are blessed with several notable Bar Associations.

One stands out, however, as a group that makes the mentoring and support of its youngest members an absolute priority. The Charles Houston Bar Association, named for the renowned African American civil rights lawyer, leader, and educator, boasts a Board of Directors comprised almost exclusively of lawyers in their first ten years of practice (including some in their first), and a President in his fifth year. By entrusting leadership positions to the young, along with ready guidance from the more "gray haired" set, this bar association trains young African American lawyers to be leaders in their profession and community.

The mission of the Forum is, of course, quite different from that of the Charles Houston Bar Association. Nonetheless, our mission must include the training of younger and less experienced practitioners in the skills and knowledge base needed to excel as construction lawyers. To this end, we have, over the past few years, expanded our outreach and welcome to young lawyers and new members.

Two groups within the Forum have led this effort. Our Membership Committee, under the leadership of Ava Abramowitz and Doug Green, has worked closely with our Young Lawyers Committee, led by Chris Caputo and our ABA Young

Lawyers Division Liaison, Eddie James, to make the Forum more welcoming to the new member. At our last several programs, these two groups have jointly sponsored receptions on the evening preceding the program. These receptions provide the invited young lawyers and new members with an opportunity to meet others of similar age and experience, share problems, get advice and make lasting friendships. As these new members grow in their careers, so will the Forum.

Our Membership Committee, with the oversight and concurrence of the Governing Committee, has also begun to offer outreach "scholarships" to enable women and minority lawyers who might not otherwise be in a position to attend a Forum Annual Meeting program to do so. We hope that this effort will expose more women and minority construction lawyers to the benefits of the Forum and attract them to become involved in our activities.

Perhaps the most remarkable initiative launched by the Membership and Young Lawyers Committees is our new Mentoring Program. Through this Program, each first time attendee to our Annual Meetings is contacted in advance of the meeting by a longstanding Forum member. In the initial contact, the mentors welcome the first time attendees and encourage them to select a Division in which they are interested. They also try to introduce the new attendee to that Division's leaders in advance of the Division Breakfast. We hope that these "ice breaker" conversa-

*(continued on page 6)*

---

# In Memoriam: Ralph L. Kaskell, Jr.

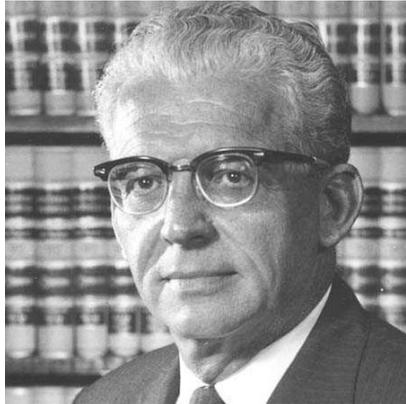
By Charles F. Seemann, Jr.

The Forum regrets to report the death on January 21, 2003, of Ralph L. Kaskell, Jr., a charter member of the Forum, our former Chair, and one of the first winners of the Cornerstone Award.

Ralph, a native of Brooklyn and a graduate of City College in Manhattan, received his LLB from Fordham Law School in 1936. He was admitted to practice in New York in 1937, where he practiced until World War II.

In 1942, Ralph was drafted and first served as a Private in the Medical Corps. He rose through the ranks, and toward the close of the war, Ralph was commissioned Second Lieutenant in the Medical Administrative Corps. In 1945, he was transferred to the U.S. Army's Judge Advocate General's Corps ("JAG") as a First Lieutenant. As a JAG lawyer, he was one of several assigned to review the war crimes trial record of General Homma during the appellate process.

By 1948, Ralph moved to the Litigation Division of the JAG offices in Washington, D.C. While there, JAG sent him to New Orleans to assist Eberhard P. Deutsch, Special Counsel for the United States, in appealing the judgment against the U.S. Government arising from the Texas City disaster. Ralph assisted Deutsch in the successful appeal, which resulted in a complete reversal of the judgment against the U.S. Government. In 1952, Deutsch



invited Ralph to join Deutsch, Kerrigan & Stiles, the New Orleans firm of which Deutsch was a founding partner. For over 40 years, Ralph was first an associate, and then a partner in that firm. An able and active trial lawyer, Ralph ultimately came to specialize in a number of areas, including insurance, construction, expropriation, and real estate appraisal law.

When the Forum Committee on the Construction Industry commenced in 1976, Ralph was a charter member. He served on the Governing Committee from 1979 until 1985, serving as Chair in 1984-85. During his career, Ralph published or presented 29 articles, most of which related to construction industry law, although some related to condemnation, the Federal Rules of Civil Procedure, and insurance problems. He was an adjunct lecturer at Loyola University Law School in New Orleans, where for many years he taught a course on construction law.

In 1986, Ralph received an Award of Appreciation from the AIA, the NSPE, and Victor O. Schinnerer &

Company "in special recognition of his long-standing and important contributions to the continuing education of members of the Bar who represent architects, engineers and other design professionals." When the Forum instituted its Cornerstone Award in 1995, Ralph was among the first award recipients.

In his personal life, Ralph loved music and the stage, and served as a member of the boards of both the New Orleans Opera Association and Le Petit Theatre du Vieux Carre. He was a lover and collector of rare and antique books and maps, and had a passion for Mardi Gras traditions. He is survived by his wife, Rosemary Kaskell, and his colleagues at Deutsch, Kerrigan & Stiles of New Orleans. He will be missed. 

*Charlie Seemann is a partner at Deutsch, Kerrigan & Stiles of New Orleans, LA and a longstanding Forum member.*

## **CORNERSTONE AWARD**

The Forum is pleased to announce that it will honor **Charles F. Seemann, Jr.**, of New Orleans, LA with its Cornerstone Award. The award presentation will be made to Mr. Seemann on May 9, 2003 at the Forum's Annual Meeting in Boston, MA.

---

# Pitfalls in Cost-Plus Contracts

*(continued from page 1)*

The typical construction owner's key interests are timely project completion, costs kept within budget; and quality consistent with the requirements of the contract specifications. Occasionally, however, the contractor's operational and costing practices can be inconsistent with the typical owner's interests and are seemingly in contradiction to the relevant provisions of these AIA agreements. The following explores potential pitfalls that arise under such contracts.

## **MOVING DIRECT COSTS TO INDIRECT COSTS**

Contract values under cost-plus-a-fee agreements (with or without a guaranteed maximum price) are most often comprised of two major cost categories: (1) direct costs, such as concrete, mechanical, and electrical, and (2) indirect costs, such as field and home office overhead. Direct cost budgets are typically based on combinations of general contractor estimates and subcontractor cost proposals. Indirect cost budgets are usually based solely on estimates prepared by the contractor. When direct cost budgets are based on subcontractor lump sum, or fixed-price, bids, there is relatively limited profit opportunity for the general contractor. On the other hand, because indirect cost budgets are based on contractor estimates and include costs that might otherwise be charged to home office overhead, contractors will instinctively look for opportunities to shift budgets from direct accounts to indirect accounts.

A common example is where the general contractor executes, or

"buys-out", a subcontracted scope of work for less than the amount in the owner/general contractor agreement. In this situation, it would not be uncommon for the general contractor to consider transferring some, or all, of the under-run amount to the general conditions or field overhead line item. As discussed below, the buy-out might also apply to a cost savings provision.

## **CONTRACTOR SELF PERFORMANCE OF WORK**

As a general rule, direct cost budgets under these contracts are usually, but not always, based on subcontractor lump-sum proposals or fixed price bids that offer limited profit opportunity for the general contractor. One traditional and ever-popular practice that can be in contradiction to the owner's interests arises when the general contractor elects to self-perform a certain scope of work, such as foundations, structural concrete, tilt-up concrete, etc. The general contractor often "justifies" self-performing such work by reporting to the owner that it can perform the work for less than or equal to the prices of its competitors.

However, unless the general contractor had previously disclosed to the owner that it planned to self-perform the work, a conflict of interest may arise. The owner's interests probably have not been advanced if the general contractor established an inflated budget, based on an in-house estimate, knowing that it would perform the work at a profit, for less than the budget. Moreover, a general contractor in this situation may argue that it

is entitled to self-perform such work and that it should be treated like the other direct cost subcontractors working under fixed-price subcontracts. Therefore, consistent with lump-sum subcontracting principles, it is not uncommon for a general contractor to object to disclosing its actual costs on self-performed work.

## **ESTIMATED VERSUS ACTUAL CONTRACTOR PAYROLL BURDENS**

Contractors are responsible for various state and federal employee payroll taxes and insurance ("payroll burdens") that can include: FICA; federal and state unemployment insurance; Workers Compensation; CGL Insurance; and E&O Insurance. The amount of payroll burdens paid by the general contractor will depend upon a number of variable factors, including the company's safety record, statutory adjustments, the state in which the contractor is based, and the location in which the work is performed. Due to these uncertainties and other factors, some contractors will include a provision in the contract that allows them to bill an estimated, predetermined percentage of direct payroll labor as "burden." In this regard, a common general contractor practice is to use payroll burden billings as a "profit center." Some contractors will use payroll burden estimates in the GMP estimate that are higher than their anticipated payroll burdens. When actual burden expenses are less than the estimates, the contractor pockets the difference. This practice would be more understandable in circumstances where the contractor was at-risk if actual labor burdens

exceeded the estimate. However, this is rarely the case under GMP contracts.

### **COST SAVINGS PROVISIONS**

Some GMP contracts contain cost savings provisions that prescribe how any cost savings, or GMP under-runs, will be shared by the parties after the completion of the work. To the inexperienced owner, this provision may seem like a good idea, because on its face it may serve to motivate the contractor to minimize costs. However, experienced owners understand that a cost saving provision can serve as either a disincentive or incentive, depending upon the circumstances of the project and the integrity of the contractor. The experienced owner also realizes that the contractor can often control whether it realizes "savings" during or after the project. A simple example occurs where the contractor buys-out a scope of work early in the project for less than the GMP budget for the item. At that point, the contractor has several options from which to choose:

A. Execute a change order to reduce the GMP.

- B. Move the savings, or under-run, to a contingency account.
- C. Move the under-run to an account that has or may experience an overrun.
- D. Let the under-run apply to the end-of-job cost savings provision.

Option A is least likely to be favored by the contractor, particularly where the design is incomplete. The contractor tends to benefit immediately under Options B and C, while delayed gratification would be better served under Option D.

The potential relationship between subcontract buy-out savings and a GMP cost savings/sharing provision merits further comment. General contractors tend to do business with a relatively small group of subcontractors in each trade. Consequently, the subcontractors become accustomed to the general contractor's bidding and subcontracting practices. It is not unusual for a general contractor to base its GMP budget on the low bid for a trade knowing that it will or should be able to buy-out that trade for less than the bid price.

Subcontractors tend to anticipate this practice by including some "give-back" money in their bid price. These practices often result in GMP line-item under-runs that apply to the end-of-job cost savings provision.

### **FEE ON DEDUCTIVE CHANGE ORDERS**

The dollar amount of the contractor's fee under a GMP contract is typically calculated by multiplying an agreed-to fee percentage (often 4 to 5 percent) times the total (direct plus indirect) budgeted cost of the work. When scope and cost are added to the work through a change order, the contractor will add fee to the cost of the work. However, when base scope and cost are removed from project through deductive change orders, the contractor will often be reluctant to reduce or give back fee. 

*Steve Holloway is an Associate Member of the Forum with the Holloway Consulting Group LLC in Denver, CO*

## **The Forum on the Construction Industry**

# **CALENDAR OF MEETINGS**

**Forum on Construction  
Annual Meeting**  
May 8-9, 2003  
Sheraton Copley Plaza  
Boston, MA

**Forum on Construction/TIPS  
Joint Midwinter Meeting**  
January 29, 2004  
Westin St. Francis  
San Francisco, CA

**Forum on Construction  
Fall Meeting**  
October 2-3, 2003  
The Mayflower Hotel,  
Washington, D.C.

**Forum on Construction  
Annual Meeting**  
May 6-7, 2004  
Hyatt Regency Gainey Ranch  
Scottsdale, AZ

---

# Message

*(continued from page 2)*

tions will make Forum meetings more welcoming to new members so that they want to get involved in Forum activities and return, with their ideas and perspective, to future Forum events.

We have also broadened our program offerings for less-experienced practitioners. This past November, we taught a one-day seminar on the Fundamentals of Construction Law in five cities across the country. At last Spring's Annual Meeting, we offered work-

shops such as "An OSHA Primer" and "Plan Reading 101." Upcoming at our Annual Meeting in Boston on May 8 and 9, we will offer workshops on analyzing project costs and "Scheduling 101."

However, the responsibility to encourage younger lawyers to become involved in the Forum falls to each of us. Those of us who enjoy positions of leadership in our firms must realize that the we are ill-equipped to provide our more junior lawyers with all of the train-

ing and networking opportunities they need to become leaders themselves. I encourage each of you to look at the young construction lawyers with whom you work - both in your firms and beyond - and encourage them to attend Forum programs and learn from their colleagues from across the country. In this way our firms, and our industry, will be better served. 

***John Heisse is the managing partner of the San Francisco office of Thelen Reid & Priest LLP.***

---

## ANNOUNCEMENT CORNER



### HEAR YE! HEAR YE! DIVISIONS ANNOUNCE BREAKFAST PRESENTATIONS FOR BOSTON

The Divisions are developing an interesting lineup of presentations for their Breakfast Meetings to be held at the Forum's Annual Meeting in Boston, Massachusetts on Friday morning, May 9, 2003. As of press time, the Divisions have scheduled the following:

#### DIVISION 1

##### **Dispute Avoidance & Resolution**

What Construction Lawyers Need to Know (But are Afraid to Ask) about Insurance Issues in 2003. Eileen Forgue and Donald Naber, both of the Construction Services Group of AON Risk Services, will be speaking on such topics as diminishing and changing coverages, developments in owner and contractor controlled wrap-up insurance programs, mold litigation, eroding Best ratings, and issues in design errors and omission coverages. Division 1 welcomes any attendee who is seeking timely and topical practice tips on insurance issues that our clients are facing every day. Come with your questions.

#### DIVISION 2

##### **Contract Documents**

Join us for an exciting presentation about the other big project in

Boston, Delta's new terminal building at Boston Logan Airport. Trey Moyer of Troutman Sanders will provide an introductory overview of the project, its principal actors, how the transaction was put together, the funding source, the contracting vehicle, the project delivery system, and the risks to the respective parties. The design team will then provide its unique perspective and the construction team will address the challenges it has encountered.

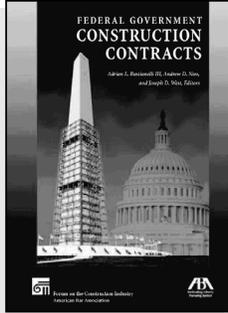
#### DIVISION 9

##### **Specialty Trade Contractors & Suppliers**

Jack O'Neill of the Western Group will give his unique perspective as inside counsel on how to deal with outside counsel, as well as contract review and negotiation. You may gain new insight making your efforts more productive.

*(continued on page 7)*

# NEW FROM THE FORUM!



## Federal Government Construction Contracts

*Adrian L. Bastianelli III, Andrew D. Ness, and Joseph D. West, editors*

**The ONLY in-depth book devoted exclusively to federal government construction contracts!**

**Written by many of the top experts in government contracts and construction law**, this new book, with over 600 pages, contains **detailed analysis and citations** in all areas of government construction contract law including:

- **Formation:** Use of the FARs, sealed bidding, competitive negotiation, design-build, IDIQ contracts, bid protests, and socioeconomic issues
- **Performance:** Changes, differing site conditions, delay, subcontracting, termination for convenience and default, pricing of claims, and payment
- **Dispute Resolution:** Claim procedures, litigation, false claims, ADR and EAJA

Most construction lawyers will handle government contract matters at some point in their careers. This book will provide the construction lawyer, consultant, and contractor who are not expert in government contract law with the basic knowledge and a road map of federal government construction contracting regulations and case law that will allow them to avoid the problems and pitfalls of government contracting.

The book also provides in-depth coverage of government construction contracting by top government contract lawyers. As a result, it will provide the experienced government contract practitioner with a sophisticated analysis of the issues and a source of case law and regulations. It will be a ready reference that the government construction contract lawyer will want to keep nearby.

Spring 2003

Product Code: 5570083

Regular Price: **\$169.00**

Construction Forum Member Price: **\$139.00**

### To order:

**Phone: 1-800-285-2221**

**Fax: 1-312-988-5568**

**E-Mail: [service@abanet.org](mailto:service@abanet.org)**

**Online: [www.ababooks.org](http://www.ababooks.org)**

## Announcement Corner

*(continued from page 6)*

### DIVISION 12

#### Owners and Lenders

Division 12 invites you to learn about current financing vehicles available in the marketplace for construction projects and what the

top ten issues are for owners and lenders when using the AIA 201 General Conditions. If interested in these topics, please join us.

As Under Construction goes to press, the remaining Divisions are

pulling together their own interesting and informative programs. Forum members planning to attend the Annual Meeting should reserve the breakfast meeting of their choice on their meeting registration forms. 



## Don't Miss the Next Forum Meeting!

**WHEN:** May 8-9, 2003

**WHERE:** The Sheraton Hotel Back Bay, Boston, MA

**TITLE:** *Revolution and Evolution in Boston: Changes and Innovations in the Construction Industry*

**TELL ME MORE:** Plenary Sessions include:

- Discovery of Electronic Information in Construction
- Standard Contract Forms: Do They Meet Client Needs and Expectations
- Force Majeure in the 21st Century
- Ethics: Conflicts in Representing Construction Clients

*Also Eight Workshops on a wide variety of topics*

**LUNCHEON SPEAKER:** The Big Dig – A Multi-Media Tour  
Michael Lewis  
*Project Director on Boston's Central Artery Tunnel Project*

*To register for this program, call the ABA at 312.988.5666 to request a brochure or download a registration form from the Forum's website at: [www.abanet.org/forums/construction/home.html](http://www.abanet.org/forums/construction/home.html) and clicking on Programs*

This year's Annual Forum Meeting will be held at the Sheraton Hotel Back Bay in Boston. Taking advantage of its historic location, the Meeting will include a private reception for all attendees at Boston's famous Museum of Fine Arts. The Meeting will showcase the Forum's twelve Divisions, each of which will also invite its members to a breakfast meeting during the conference. The opening plenary session, organized by the Construction Litigation Committee, will discuss cutting-edge developments in the discovery and protection of electronically stored documents. In addition to the four plenary sessions, eight workshops will cover varied topics including an update on liability for mold, project cost accounting, project labor agreements, smart building technology, dispute resolution innovations, a two-part workshop on development and tactical use of project schedules, and an outline of federal contract statutes. On the day immediately following the program, the DRB Foundation will provide a special workshop on dispute resolution boards that should be of special value for those who work with or serve on such boards. The Forum will also hold its annual organizational meeting. There will be many opportunities for members to learn how to become more active in Forum projects and Divisions. We have planned this year's Annual Meeting with great care, and we urge all members to join what promises to be a highly educational and enjoyable event!



### UNDERCONSTRUCTION

The newsletter of the  
ABA Forum on the  
Construction Industry

March 2003

*Lawyers Serving  
the Construction Industry  
through Education and Leadership*

American Bar Association  
750 North Lake Shore Drive  
Chicago, IL 60611

Non-Profit  
Organization  
U.S. Postage  
**PAID**  
American Bar  
Association