

Take precautions to manage risk during construction projects

Establish procedures to reduce claims during hotel renovations

By Brian Fielden

Given the current state of the financial markets, many hotel owners and operators have significantly scaled back their planned hotel development and renovation projects, or even canceled some ongoing projects. However, some owners and operators are realizing the benefits of, or necessity for, undertaking renovations in this competitive market.

This uncertain, economic environment raises a particular need for these owners and operators to properly manage construction risk and avoid claims on their renovation projects. Here are 10 tips to help reduce risk:

1. Establish company-approved contract forms to maintain control over contractual risks being documented. Most often, the underlying cause of construction claims and disputes is because companies do not have approved contract forms. Various project managers are using and negotiating different company forms or responding to forms produced by third parties, and therefore don't have effective control over the contract documents used by the company and the contractual risks being documented.

2. Establish procedures for oversight of completed contracts. Without contracting procedures that require the involvement of senior business personnel or in-house counsel, companies often have no idea of what its signed contracts provide in terms of risk. These issues are often only discovered later, when substantial claims arise. For example, approved contract terms are often changed without input from in-house counsel. Alternatively, vendor proposals are often attached to the final contract, or incorporated by reference. Proposals often contain outdated scope informa-

tion, or terms and conditions that conflict with the contract (such as limitations of liability).

3. Ensure early contract negotiation and execution. Companies often lose substantial negotiating leverage because form contracts are provided to architects or contractors weeks or months after they are awarded the job, and important provisions are worked out at the "last minute." Even worse, contracts typically are not signed until services have commenced, which can put the company at substantial risk (e.g., no contractual indemnity). Formal procedures should require business personnel to provide contract forms to vendors when services are requested, including inserting contract forms in bid packages. This allows vendors to base their prices on company forms, and contested contract provisions can be identified and addressed promptly.

4. Establish controls to protect against liens and claims through the payment process. Internal accounting procedures and contractual payment provisions should be drafted so that each progress payment is an opportunity to "bring the project current" in terms of outstanding matters or claims. Contractors should be required to submit interim lien waivers (for itself and subcontractors), waiving lien rights through the last pay application date. Companies can obtain additional protection by including language that also waives contract claims through that same date. This will "bring the project current," providing comfort that no hidden or unknown claims exist after each payment.

5. Avoid making cash deposits on FF&E in this risky economic environment. In recent times, some hotel companies have made substantial cash deposits for FF&E, only to find the FF&E supplier insolvent or in bankruptcy when delivery is required. Companies should consider taking immediate delivery, then warehousing the FF&E, or using a letter of credit in lieu of a deposit if warehousing is not an option.

6. Include contract provisions addressing contractor coordination/conduct issues for hotels to be occupied during the renovation. If the hotel will be occupied during the renovation, provisions must be included in the construction contract regarding constraints on working hours, worker conduct, construction access issues, storage and staging of materials, and coordination with on-site hotel management. Most standard industry contracts do not adequately address these issues.

7. Carefully coordinate owner-supplied FF&E with the contractor's schedule to avoid claims for delay and extra costs. Delivery of FF&E, especially those requiring long lead times, should be carefully coordinated with the contractor's schedule before the contract is signed. Delays will result in contractor claims for extra costs. Owners should also ensure that FF&E suppliers are contractually accountable for these delay costs.

8. Avoid using financially unstable project participants with thorough prequalification procedures. In this uncertain economic climate, it is critical to thoroughly prequalify all project participants. Bankruptcy by a contractor or key subcontractor can lead to delayed completion and ultimate project disaster. Prequalification forms should request critical information, including bank accounts, bonding capacity, lawsuits and references.

9. Include termination for convenience provisions to account for contingencies. Due to constantly changing conditions in this environment, owners should give themselves maximum flexibility to cancel a project at any point by including a "termination for convenience clause." This allows owners to terminate contracts without being in "breach of contract" and liable for damages. The contract should be clear that the terminated contractor is only entitled to be paid for work performed and fees earned through termination, and not unearned profit on the entire contract or other consequential damages (which most form contracts allow).

10. Prohibit verbal change orders in contracts to avoid disputes. Allowing one's construction representative to authorize verbal changes in the work without supporting documentation is simply asking for trouble, as disputes will inevitably occur. Internal procedures and contract forms should require that all changes requiring an adjustment in the contract price or time should be allowed only by written change order from a specified authorized representative. This will also help prevent contractors from claiming that on-site hotel staff gave instructions for changes entitling them to extra costs.

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