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Negotiating Warranty Clauses With Your Client's Best Interests In Mind

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After litigating numerous cases on behalf of Contractor and Construction Manager clients and reviewing, drafting and negotiating hundreds of construction agreements, the author is familiar with the significant legal and commercial risks posed by these agreements. This Practice Note will focus on risks specifically associated with warranty provisions in construction agreements and identify, in instances where negotiation is possible, appropriate changes that will clarify certain provisions, provide additional protections or more fairly allocate risks. It's a broad subject so please bear in mind that this Practice Note is far from exhaustive. However, in the limited time and space available, we will discuss, from the perspective of the Contractor or Construction Manager at risk, practical negotiation strategies for both express warranties (by the Contractor and by the Owner) and implied warranties (by the Contractor) and focus on:

1. What's best for your client?
2. What clauses must your client have?
3. What clauses should your client strive to avoid?

I. Introduction to "typical" express warranty (by Contractor) provisions

While no two construction agreements are alike, it is helpful to have some familiarity with the important provisions contained in certain "standard" documents often used by Owner attorneys to draft customized agreements on behalf of their clients. One such document is the American Institute of Architects ("AIA") A201-2007 General Conditions. It contains the following express

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Contractor warranty provisions (with bolding added for purposes of discussion):

§ 3.5 WARRANTY

The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, materials, or equipment not conforming to these requirements may be considered defective. **The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the Work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage.** If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

§ 12.2.2 AFTER SUBSTANTIAL COMPLETION

§ 12.2.2.1 In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1, **or by terms of an applicable special warranty required by the Contract Documents,** any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of Work, **if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty.** If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.

§ 12.2.2.2 The one-year period for correction of Work shall be extended with respect to portions of Work first performed after Substantial Completion by the period of time between Substantial Completion and the actual completion of that portion of the Work.

§ 12.2.2.3 **The one-year period for correction of Work shall not be extended** by corrective Work performed by the Contractor pursuant to this Section 12.2.

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§ 3.12.6 By submitting Shop Drawings, Product Data, Samples and similar submittals, the Contractor represents to the Owner and Architect that the Contractor has (1) **reviewed and approved them**, (2) determined and verified materials, field measurements and field construction criteria related thereto, or will do so and (3) checked and coordinated the information contained within such submittals with the requirements of the Work and of the Contract Documents.

§ 3.2.1 Execution of the Contract by the Contractor is a representation that the Contractor has visited the site, become generally familiar with local conditions under which the Work is to be performed and correlated personal observations with requirements of the Contract Documents.

II. Analysis of express warranty provisions (by Contractor to Owner)

If your eyes have already glazed over, it's not surprising and nothing to be embarrassed about. However, you need to pull out the Visine and carry on because, as the attorney drafting and negotiating these provisions on behalf of a Contractor, you've got to really see and understand what these provisions mean and how they affect your client. Let's talk about:

What's (ideally) best for your client?

1. **Limiting the Construction Warranty to an express promise to correct non-conforming Work (limited to labor and materials) for a period of no more than 1 year from the date of Substantial Completion (exclusive of latent defects).** Because the bolded language in § 3.5 limits your client's obligation to make repairs, you'll want to guard against the Owner deleting it. You'll also notice that § 3.5 does not specifically reference a 1 year construction warranty. Although § 12.2.2 does reference the 1 year construction warranty period, best practice is to include it in § 3.5 as well.

2. **Waiver of Owner warranty claims for non-latent defects after that 1 year period.** We've bolded this language in § 12.2.2.1 because it's frequently deleted by the Owner. If it's deleted, your mission is to ask that it be put back.

3. **Limiting representations regarding review and approval of submittals.** You'll want to limit the effect of the bolded language in § 3.12.6 by including in your agreement a disclaimer of liability for design errors and omissions (unless your client is acting as a design-builder).

4. **Limiting site inspection representations to observable surface conditions.** This modification applies to the warranty contained in § 3.2.1.

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What clauses must your client have?

1. A Construction Warranty limited to a definite period and repair/replacement obligations subject to notice/reasonable opportunity to commence to cure requirements.

If the Owner wants a 2 year construction warranty, that's fine if the Contractor has the ability to price that additional obligation into the agreement. However, an unlimited warranty obviously presents unlimited risk.

2. Flow down of all warranty responsibilities to appropriate Subcontractors and Suppliers.

Your client should not agree to be the guarantor of warranties supplied by Subcontractors and manufacturers of specific pieces of equipment. Rather, your client should serve as the conduit to provide those warranties directly to the Owner and be the coordinator of any necessary repair work performed by the appropriate Subcontractors.

3. No responsibility for design errors or omissions unless your client specifically agrees to perform such services through licensed professionals it retains.

What clauses should your client strive to avoid?

1. Implied warranties (UCC or common law). Be on guard against "cumulative remedy" provisions in the agreement that may expose your client to liability for breach of common law warranties such as "fitness for particular purpose" or "warranty of merchantability."

2. Warranty periods longer than 1 year that may be "buried" in Project specifications or other Contract Documents

3. Warranties that may be triggered by the Owner's negligence or failure to properly maintain the Project premises

4. Lack of reasonable notice/opportunity to cure time periods. Ask your client how much time it requires in the real world to respond to a demand by the Owner for performance of warranty work.

5. A "renewing" warranty (A201-2007, Paragraph 12.2.2.3).

If the Owner removes the word "not" from this clause, your client is on the warranty hook for up to 2 years.

III. Introduction to "typical" express warranty (by Owner) provisions

Hopefully your Visine is still working as we review additional AIA A201-2007 clauses:

§ 2.2.3 The Owner shall furnish surveys describing physical characteristics, legal limitations and utility locations for the site of the Project, and a legal description of the site. The Contractor

shall be entitled to rely on the accuracy of information furnished by the Owner but shall exercise proper precautions relating to the safe performance of the Work.

§ 2.2.4 The Owner shall furnish information or services required of the Owner by the Contract Documents **with reasonable promptness**. The Owner shall also furnish any other information or services under the Owner's control and relevant to the Contractor's performance of the Work **with reasonable promptness** after receiving the Contractor's written request for such information or services.

§ 15.1.3 Pending final resolution of a Claim, except as otherwise agreed in writing or as provided in Section 9.7 and Article 14, the Contractor shall proceed diligently with performance of the Contract and the Owner shall continue to make payments in accordance with the Contract Documents. The Architect will prepare Change Orders and issue Certificates for Payment in accordance with the decisions of the Initial Decision Maker.

IV. Analysis of express warranty provisions (by Owner to Contractor)

What's (ideally) best for your client?

- 1. The ability to rely upon information and services supplied by the Owner (including information regarding subsurface conditions and utilities).** Owners frequently delete the language bolded in § 2.2.3 and replace it with a statement that information they supply is for reference only and not to be relied upon.
- 2. Having the Owner warrant that required information and services shall be provided timely "so as not to delay the progress of the Work" (and inclusion of failure to do so in the list of compensable delay events).** This is especially important if your client is subject to Liquidated Damages if the project is delayed.
- 3. Having the Owner warrant that payments shall be made timely in accordance with the requirements of the Contract Documents.** The ability of an Owner to cash starve a project with impunity is a prescription for disaster.

What clauses must your client have?

- 1. Regular payments within commercially reasonable intervals.**
- 2. A submittal schedule that accords with the overall project schedule.**
- 3. Time extensions for delays caused by the Owner or Architect.**

What clauses should your client strive to avoid?

1. **Shifting of design liability to the Contractor.** This is a potential danger whenever the Contractor is required to review design documents during the preconstruction phase.

2. **Contractual rejection by the Owner of liability for concealed/subsurface conditions or unforeseen hazardous materials.** Be aware that Owners sometimes require Contractors, after examining documents supplied by the Owner, to "assume all risks" associated with subsurface conditions. This requirement is, in almost all cases, unreasonable and should be rejected.

3. **Deletion of the bolded language in § 15.1.3.** Without this language, in the event of a dispute, the Owner can stop paying and your client will be placed in the position of financing the project until resolution of the dispute (which may be years later).

V. Introduction to "typical" implied warranty (by Contractor) provisions

These provisions are from New York's adaptation of the Uniform Commercial Code, and in some shape or form are included in the statutory or common law of all other states:

McKinney's Uniform Commercial Code § 2-314

§ 2-314. Implied Warranty: Merchantability; Usage of Trade
Currentness

(1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316) other implied warranties may arise from course of dealing or usage of trade.

McKinney's Uniform Commercial Code § 2-315

§ 2-315. Implied Warranty: Fitness for Particular Purpose

Currentness

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

VI. Analysis of implied warranty provisions (by Contractor to Owner)

What's (ideally) best for your client?

1. Avoidance of all implied warranties (UCC or common law). Exposure to UCC remedies may include liability for consequential damages.

What clauses must your client have?

1. A Construction Warranty limited to a definite period and subject to notice and a reasonable opportunity to commence to cure.

What clauses should your client strive to avoid?

1. The answer to this question is the same as the answer to the question "what's best for your client."

VII. Conclusion

Warranties can be discussed in far greater detail and are only part of a much larger picture in the context of drafting and negotiating a construction agreement. Hopefully, this Practice Note gets you thinking about some of the key issues and provides useful advice regarding at least a few of those issues. Thanks for your attention and apologies for any eye strain.