

Warranties in Construction Contracts: Contractor's Drafting Considerations

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Warranty obligations in a construction contract must be carefully drafted by the contractor's counsel to avoid the contractor assuming risks it did not contemplate or account for in its price. This Practice Note describes the types of warranty obligations generally found in construction contracts and provides guidance to contractor's counsel on what to demand and avoid during the negotiation process.

Contractors are routinely called on to provide warranties of the work they perform under a construction contract. However, careful drafting is required by the contractor's counsel to ensure that the contractor's warranty obligations are limited to responsibility for the contractor's own work and only continue for a set period of time.

This Note focuses on contractor risks specifically associated with warranty provisions in construction agreements. It identifies, in instances where negotiation is possible, suggested changes that:

- Clarify the extent of certain provisions.
- Provide additional protections.
- More fairly allocate risks.

This Note discusses, from the perspective of the contractor or construction manager at risk (collectively, contractor), practical negotiation strategies for both express warranties (by the contractor and by the owner) and implied warranties (by the contractor) and focuses on the clauses:

- That are most favorable for a contractor.
- A contractor should insist on during negotiations.
- A contractor should avoid whenever possible.

"TYPICAL" CONTRACTOR EXPRESS WARRANTIES

While no two construction agreements are alike, many attorneys rely on the language in standard industry form agreements or use them as a starting point for customized agreements (see *Practice Note, Standard Construction Industry Documents: Overview* (<http://us.practicallaw.com/9-560-0605>)). Therefore, it is helpful to have a basic understanding of how those agreements approach contractor warranties. Commonly used agreements include:

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- **American Institute of Architects (AIA) A201-2007, General Conditions for the Contract of Construction.** The AIA General Conditions is perhaps the most commonly used form agreement as a companion to a variety of contractor and construction management agreements. The AIA A201 contains an express warranty provision (§ 3.5), but also includes other sections that create warranty obligations on behalf of the contractor.
- **ConsensusDOCS (CD) 200, Standard Agreement and General Conditions Between Owner and Constructor (Lump Sum Price).** This form agreement, and a form of owner-construction manager agreement (CD 240), each contain an express warranty provision (§ 3.8) as well as other sections that are often considered warranty obligations.

Express warranties in these two documents as well as other warranties commonly used in construction contracts cover:

- **Materials and equipment.** Contracts customarily provide that the materials and equipment furnished under the contract will be new and of good quality. Some contracts go further to warrant that the material and equipment will be free from defects, such as CD 200 § 3.8.1.
- **The Work.** What constitutes the "Work" is a defined term in a construction contract, as are the "Contract Documents" that detail the scope of the Work to be performed (see *Practice Note, Changes in the Work: Drafting Strategies for Construction Contracts: Scope of Work* (<http://us.practicallaw.com/5-573-5705#a978588>)). It is customary for the contractor to warrant that the Work will conform to the requirements of the Contract Documents. Usually the contractor will also warrant one of the following:
 - the Work will be free from defects;
 - the Work will be free from material defects; or
 - the Work will be performed in a good and workmanlike manner.
- **Special warranties.** In some instances, the specifications call for warranties of specific equipment or systems. CD 200 contains a provision specifically addressing these special or extended warranties (§ 3.8.3), and calls for a schedule to be annexed to the agreement to draw attention to any special requirements.



WARRANTY EXCLUSIONS

Contracts customarily relieve the contractor from responsibility to repair any Work where the damage or defect results from:

- Alterations to the Work not performed by the contractor.
- Abuse of, or damage to, the Work caused by third parties.
- Improper use of the material and equipment other than for its intended purpose.
- The owner's failure to properly operate or maintain the Work, including monitoring or servicing equipment if required by the specifications.
- Normal wear and tear.

"CALL-BACK" REMEDY

Construction contracts customarily contain a provision requiring the contractor to cure any defective work for a period of time (usually one year) after the work has achieved "Substantial Completion" as defined in the contract (AIA A201 § 12.2.2; CD 200 § 3.9). While not expressly couched as a warranty, the contractor's obligation to cure defective work that was warranted to be free from defects is often referred to as a call-back warranty.

This provision requires the owner to give the contractor notice of any defective work and obligates the contractor to return to the project if necessary and cure the defect. The clause may be drafted to either:

- Require the contractor to cure any defect discovered by the owner during the one-year period so long as it is promptly reported.
- Only obligate the contractor to cure any defect of which the owner has given actual notice within the one-year period.

Other factors often addressed in the call-back warranty include:

- The amount of time the contractor has to accept responsibility for and cure the defective work before the owner can undertake the repair at the contractor's expense.
- The costs for which the contractor is responsible in the event of defective work.
- Whether the performance of corrective work extends the one-year for correction of the Work.
- Whether the owner's failure to give the contractor timely notice of defective work and an opportunity to cure waives the owner's right to later demand a cure or make a claim for breach of warranty.

CLAUSES THE CONTRACTOR MUST HAVE

When drafting warranty provisions, contractor's counsel should negotiate for the following:

- **A warranty for a limited and defined period of time.** The contract language should expressly limit all warranties to the time period and notice requirements in the call-back warranty. It is a common misconception that the express warranty period is automatically limited to the call-back period. For example, the obligation in AIA 201 § 12.2.2.1 is expressly in addition to the warranty obligations in section 3.5, which section does not contain any warranty period. Therefore, it is best practice to restate in the express warranty section (such as AIA 201 § 3.5) that the warranty is limited to the same one-year period as the call-back remedy.

The parties can negotiate for a period longer than one year provided that the contract price includes the assumption of that additional risk. Under no circumstances should the contractor agree to an unlimited warranty period and the associated unlimited risk.

- **A warranty period that is not extended by remedial work.**

Contractors should also avoid extending the one-year (or other defined) warranty period by allowing any remedial work to extend the warranty period. Both AIA A201 (§ 12.2.2.3) and CD 200 (§ 3.9.2) expressly provide that the original warranty period is not extended when remedial work is performed. Contractor's counsel should be careful not to allow owner's counsel to delete the word «not» from these form provisions.

Contractors should be aware that for work performed after substantial completion (which usually triggers the start of the warranty period), the one-year warranty period is extended to run from the date that work is completed (AIA A201 § 12.2.2.2; CD 200 § 3.9.2). However, the contract should make clear that any extension of the warranty period is only for the work first performed following substantial completion.

- **Notice of any warranty claims and a reasonable opportunity to commence any repair or replacement.** Counsel should consult with its client about what is a reasonable time period to perform any required warranty repair. This provision enables the contractor to:
 - confirm that the repair is covered by the warranty;
 - determine whether its Work was modified in any way that relieves it of warranty responsibility (see *Warranty Exclusions*); and
 - control the cost to remedy any defective work.
- **Flow down of all warranty obligations to the appropriate subcontractor or supplier.** A contractor should not agree to be the guarantor of warranties supplied by subcontractors and manufacturers of specific systems or pieces of equipment. The contractor should instead secure those warranties from the applicable manufacturer or subcontractor directly in favor of the owner and coordinate any necessary repair work to be performed by the appropriate subcontractor. The contractor should also confirm that the trigger date for the lower tier contractor's warranty obligations is consistent with the requirements of its contract to avoid a gap in warranty coverage that may obligate the contractor to pay for extended warranty coverage.
- **No responsibility for design errors or omissions.** A contractor should only be responsible for design errors and omissions when it specifically agrees to assume certain design responsibilities and hires a licensed design professional to perform those services.

Contractor's counsel should also be aware of certain other contractual representations that may have the unintended effect of making the contractor responsible for design defects, such as contractor representations to the owner that it has:

- reviewed and approved shop drawings, product data or other submittals for which another party is responsible (AIA A201 § 3.12.6); or
- visited the site and correlated its personal observations with those of the Contract Documents (AIA A201 § 3.2.1).

Contractor's counsel should not allow the contractor's warranty obligation to be expanded to warrant that the Work will comply with all building codes, rules and regulations, because it is the design professional's obligation to ensure the design's compliance with those legal requirements.

CLAUSES THE CONTRACTOR SHOULD AVOID

Contractor's counsel must also take into consideration the impact of those legal obligations that are not expressly addressed in the more obvious warranty provisions, including:

- **Implied warranties.** These warranties can arise through application of the Uniform Commercial Code (UCC) or common law principles. Counsel should be particularly careful to avoid contractual cumulative remedy provisions that can create common law liability for implied warranties such as:

- fitness for a particular purpose; or
- warranty of merchantability.

Counsel should check statutes and case law in the applicable jurisdiction to determine whether:

- any implied warranties are recognized;
- those implied warranties apply to commercial properties or only to the construction of new residential properties; and
- the parties can waive those implied warranties.

Even if permitted, courts usually strictly construe any language purporting to waive implied warranties. Counsel should therefore confirm any drafting requirements, such as:

- specific text acknowledging the waiver;
- requirements for font size, color or emphasis for the text to ensure that it is conspicuous; and
- designated location for the waiver language.

- **Warranty periods that are buried in project specifications or other contract documents.** The contractor's counsel must confirm with its client that the specifications do not contain specific warranty obligations that are greater than the one-year or other negotiated warranty period in the contract. It is not unusual for contracts to provide that in the event of a conflict or inconsistency, the specifications take precedence over the contract itself or the contractor is held to the more stringent requirements (see *Practice Note, Changes in the Work: Drafting Strategies for Construction Contracts: Scope of Work* (<http://us.practicallaw.com/5-573-5705#a978588>)). Therefore, a contractor may unknowingly provide a longer than intended warranty period. Identifying these requirements at the outset ensures that any extended warranties are obtained from relevant subcontractors and equipment manufacturers.

- **Warranty obligations that may be triggered by the owner's negligence or failure to properly maintain the project premises.** It is critical that the warranty obligation exclude coverage for acts or omissions of the owner (see *Warranty Exclusions*). Examples can include:

- repairs that are normal maintenance under a service contract the owner is required to obtain following testing and acceptance of equipment;
- repairs that are the result of the owner's failure to obtain the service contract or perform required maintenance of the equipment;
- improper operation of equipment; or
- changes made to the equipment that cause it to malfunction.

"TYPICAL" OWNER WARRANTIES

Unlike the specific heading for contractor warranty responsibilities (AIA A201 § 3.5 and CD 200 § 3.8), the owner's warranties take the form of representations sprinkled throughout the contract. Examples include:

- **Representations about site conditions.** The owner customarily provides the contractor with certain information about the site (AIA A201 § 2.2.3; CD § 4.3), which can include:
 - a survey describing the physical characteristics and legal limitations for the project site;
 - a legal description of the site;
 - information about the existence and possible interference of utilities affecting the project site;
 - information about the presence, or potential presence, of hazardous materials; and
 - information about subsurface conditions.
- **Timeliness in providing information.** Contracts customarily require the owner to provide information to the contractor with "reasonable promptness" (AIA A201 § 2.2.4; CD 200§ 4.3), both at the start of the project and as it comes into the owner's possession.
- **Obligation to make timely payments to the contractor.** Owners often negotiate for contract language that enables them to withhold payment for a variety of reasons. However, to prevent the project from being cash-starved, the contract should still require the owner to pay undisputed amounts or provide a formula for partial payment of sums that are legitimately in dispute (see *Practice Note, Payment Provisions in Construction Contracts: Drafting Strategies: Grounds for Withholding or Rescinding Approval* (<http://us.practicallaw.com/1-568-1506#a761413>)).

CLAUSES THE CONTRACTOR MUST HAVE REGARDING OWNER WARRANTIES

When negotiating owner warranty provisions, contractor's counsel should negotiate for the following:

- **Ability to rely on information provided by the owner.** The contractor should negotiate for the owner to provide as much information as possible about conditions at the site that may potentially impact the performance of its Work. The more information available to the contractor, the better it is able to prepare for and price the risks associated with the Work. Owners often attempt to shield themselves from responsibility for the accuracy of the information they provide by stating that information is being provided for reference only. Contractor's counsel should secure one of the following options for its client:
 - insist on language that entitles the contractor to rely on the accuracy of the information provided by the owner, for example, as contained in AIA A201 § 2.2.3;
 - negotiate for the contractor to perform its own preconstruction investigation on which it can rely in preparing its bid; or
 - negotiate for the contractor's right to obtain a change order if once construction begins, conditions are materially different than was represented by the owner.
- **Recourse for the owner's failure to act in a timely manner.** Requiring the owner to provide required or requested information in a reasonably prompt manner is vague and does not provide the contractor with a tangible remedy if the owner does not comply. Contractor's counsel should qualify the obligation by including language requiring the owner to act "so as not to delay the progress of the Work." Counsel should also include the owner's failure to act in a timely manner in the list of compensable delay events. This is particularly important if the contract contains a liquidated damages clause.
- **Continuing payment stream during disputes.** Disputes are inevitable on a construction project, particularly regarding the entitlement to or pricing for changed work (see *Practice Note, Changes in the Work: Drafting Strategies for Construction Contracts: Change Order Dispute Resolution* (<http://us.practicallaw.com/5-573-5705#a477157>)). Contractor's counsel should ensure that the contract provides a mechanism for payment to continue to be made to the contractor, even if in a reduced amount, while the dispute is being resolved (see *Practice Note, Changes in the Work: Drafting Strategies for Construction Contracts: AIA and ConsensusDOCS Payment Provisions* (<http://us.practicallaw.com/5-573-5705#a126112>)).

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