

# Construction Contract Negotiation

**Educational Goals** Introduce students to construction law, contracts, parties on a construction project, contractual relationships, contract administration/interpretation, construction claims (delay/differing site conditions), dispute resolution, negotiation, and settlement. Enhance students' negotiating skills. Introduce students to a legal career in the construction industry.

**Description** In this three-part activity, mentors first present background information about the different parties on a construction contract, the essential terms of a contract, and the sources of law for construction contracts. Mentors also provide students with negotiating tips. Students are then divided into three teams, one representing the Owner, one playing the role of the General Contractor, and the third acting as a Subcontractor. The contract dispute arises over a problem excavating the foundations of a new school. After the three parties to the contract go through a mock negotiation, mentors lead students through a post-negotiation analysis of lessons learned. And time permitting, the mentors demonstrate a negotiation for the students.

While this activity can be conducted without a lawyer, the involvement of an attorney on the mentor team can be beneficial. An attorney familiar with construction law would be ideal. The American Bar Association Forum on the Construction Industry is preparing a list of volunteers in your area who may be available to help. Please contact ACE National for an updated list.

**Time** 1.5-2 hours

## Materials

- ▶ **PowerPoint Presentation.** Background Information. If a projector is not available, pass out to students printed copies of slides.
- ▶ **General Negotiation Scenario.** This can be distributed to students as they arrive, before the formal program starts, so that they can start learning the facts of the case.
- ▶ **2 Contracts** (see copies at the end of this activity description). They can be distributed to students as they arrive.
  - **Prime Contract** (Agreement Between Owner and General Contractor)
  - **Subcontract** (Agreement Between General Contractor and Subcontractor)
- ▶ **"Confidential" Negotiation Strategy Sheets for Owner, General Contractor, and Subcontractor** (see copies at the end of this activity description). These should not be distributed until just before the students break up into the 3 role-playing teams. Take care to distribute the appropriate sheet to the correct negotiating team.
- ▶ **2-3 sheets of paper for drafting simple Settlement Document.**

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## **I. Background information (10-15 minutes)**

Using a PowerPoint presentation (or hard copies of PPT slides), mentors give students a general introduction to the parties typically involved in a construction contract, the elements of a contract, the sources of law, and negotiating tips. If an attorney is part of the mentor team, this individual is most appropriate to give the introduction. However, by virtue of their experience in the construction industry and with the aid of the notes below, other mentors should have adequate knowledge to make this presentation.

### **A. Parties on a Construction Project Slide**

### **B. Basic Elements of a Construction Contract Slide**

- i. Essential Terms of a Contract
  - 1. Price
  - 2. Scope of work
  - 3. Duration
- ii. Typical Payment Methods
  - 1. Lump Sum (Low Bidder)
  - 2. Cost of the Work Plus a Fee (Time and Materials)
  - 3. Cost of the Work Plus a Fee with a Guaranteed Maximum Price (GMP)

### C. Sources of Law Slide – how are contracts interpreted in a dispute?

- i. Common Law: Prior on-point case decisions, e.g. *Spearin v US*, decision in the US Supreme Court. In *Spearin v US*, the court held that the contractor will not be liable to the owner for loss or damage which results from defects in the plans and specifications. In other words, if the contractor relies on the plans that the Owner gives it, then if the plan was not buildable, the contractor can't be held liable for the resulting failure.
- ii. Can ask students “does anyone know any US Supreme Court cases?”
- iii. Statutes and Regulations: Laws addressing construction in your region passed by a government body. For example, laws ensuring subcontractors and suppliers get paid on a project (construction liens); licensing of architects, engineers, and contractors; and applicable building codes.
- iv. Primary Types of Dispute Resolution
  1. Negotiation/Settlement – negotiating a settlement with the other party.
  2. Mediation – Confidential, often used to facilitate a settlement. Neutral third party assists the parties in reaching a settlement. If a settlement is reached, it is binding. In mediation, the parties have the ability to control the outcome of their dispute.
  3. Litigation (Court System)/Arbitration – both binding on parties. The outcome of the dispute is decided by a judge, jury or arbitrator.



### D. Negotiation Tips Slide

- i. Use your arguments
  1. Getting to Yes Pointers
    - a. Separate people from the problem. Understand why other side wants what they want. Communicate – don't argue. Explain your position.
    - b. Focus on interests. Identify shared interests. It's not what you want; it's what you need.
    - c. Invent options for mutual gain. Find creative solutions – Is there something other than money that is valuable to the other side?
    - d. Insist on using objective criteria. Concentrate on merit; is a proposal reasonable?
- ii. Start low/high - But don't go too high, avoid false claims
- iii. Take breaks/talk with your team - Sometimes you need time to re-group, or let the other side stew.
- iv. Explain position to the other side - Getting to Yes pointers (see above)

### E. Negotiation Module Slide

- i. Give overview of activity and procedures.

## II. Negotiation Activity (approximately 60-70 minutes)

- A. Introduction (15 minutes)** – Explain how the activity will work. Distribute copies of:
- General Negotiation Scenario
  - Prime Contract
  - Subcontract
  - an extra copy of slide #2, Parties on a Construction Project and allow students to read through the documents. Answer any questions students may have about the handouts. They can be passed out at any time before this, including when students first arrive before the formal start of the session. Do NOT hand out Confidential Negotiation Strategy Sheets yet.
- B. Form Negotiation Teams** – Divide students into three teams per negotiation (owner, contractor, and subcontractor), either by random assignment or selection. Student teams of 2 or 3 students are preferable, so that all students have the chance to vocally participate. This adds to the complexity of the activity because the teammates must present the same front in a negotiation.

If more than 3 students are on a team, some of them may not participate fully. Therefore, if the total number of students exceeds 9, it would be advisable to create two separate negotiations, one with 6 students participating and the other with the remaining students broken out as suggested below.

Total # of Students	Owner (School District)	Contractor (General Contractor)	Subcontractor (Big Dig Excavation)
3	1	1	1
4	1	2	1
5	1	2	2
6	2	2	2
7	2	3	2
8	2	3	3
9	3	3	3
10 or Greater	Teams of 2	Teams of 2	Teams of 2

- C. Caucus of Negotiating Teams (10-15 minutes)** – Each of the three negotiating parties (owner, general contractor, subcontractor) should caucus privately to develop their negotiating strategy and prepare their arguments. If possible, a mentor should serve as an advisor to each group and answer questions. Hand out the Confidential Negotiating Strategy Sheets to the appropriate parties, one copy for each student on the team. Advise the students to prepare for what they think the other side will use as arguments.

**D. Three-party Negotiations (30 minutes)** – It helps to have all three teams face each other in a triangle or around three sides at the end of a large conference table. (If because of the number of students it is necessary to have two separate sets of negotiations, then each negotiation activity should take place in separate rooms.)

***Mentor Tips for the Negotiation:***

- i. Advise the parties they have a half hour, but allow it to run to 45 minutes if a settlement is not reached and you have extra time available.
- ii. The Subcontractor, Big Dig Excavation, normally starts talking first, since that party is making the claim for extra compensation.
- iii. During the actual process of negotiation, mentors should be bystanders and not active participants with a team.
- iv. Let teams come up with their own ideas and arguments to try on the other side.
- v. If appropriate, suggest that the teams take a break from the three-party negotiation and let them talk two-parties at a time (along contract lines, owner-contractor or contractor-subcontractor).
- vi. Offer to let groups take a break in order to caucus with their teammates, if necessary. Mentors can convene with the teams and offer some new suggestions, if they seem warranted
- vii. If the teams are stuck on positions for a long time (generally over 10 minutes), prompt the group to start discussing dollars.
- viii. Mentors should take notes of things they notice during the negotiation for purpose of the wrap-up discussion. Section III below suggests questions and points that mentors can focus on during the negotiation.



**E. Settlement Agreement**

The negotiation is not concluded until a simple settlement agreement is prepared and signed by the parties. Explain that this is good practice to ensure no party reneges later. For example, this can be as simple as “Owner agrees to pay Contractor \$\_\_\_\_ to resolve dispute,” with the agreed to amount and signed by both parties. One agreement for all three parties may be used, or different agreements between the Owner-Contractor and Contractor-Subcontractor.

### III. Wrap-up Discussion (20-30 minutes)

#### A. Post-negotiation discussion (approximately 20 to 30 minutes)

- i. Compare results and ask each group questions. They can be specific to individual situations that mentors witnessed, e.g. “What were you thinking when \_\_\_\_\_ happened in the negotiation?” Example questions:
  1. What happened?
  2. Who made first offer?
    - a. What do you do if you receive an unreasonably low offer?
  3. How did you prompt the other side to lower its offer?
  4. Why did you give in/concede?
    - a. How fast did you concede ground?
  5. Did any party threaten to walk out?
- ii. Discuss key points in the scenario and negotiation tips for each.
  1. Difference in contract terms between owner and contractor versus contractor and subcontractor.
  2. Explain to students that all teams had equal strength positions; two arguments for and two against, the same dollar amounts at stake (explained in part B below). Use the arguments you have.
  3. Watch out for body language, what your body gives away while you are talking; how you react to things (poker face); comments whispered to your teammate during the negotiation the other side can hear.

**B. Compare Negotiation Results** – Some people say that a good settlement is where all parties walk away unhappy. This scenario is designed so that all three parties have equal liability. Each party has two arguments for and two arguments against their position. The dollars work out so that a perfectly equal resolution would be each party giving away 33 cents on the dollar. In other words, an equal split when the owner pays \$33,333, the contractor pays \$33,333, and the subcontractor takes \$66,666 (\$33,334 less than the \$100,000 claim value).

- i. Tell students that all parties are winners because they reached an agreement. Reaching a settlement was the goal of the activity.
- ii. However, it is possible to compare degree of success. The “winner” is whichever party “gives up” the least amount. An easy way to calculate this is to subtract what the subcontractor paid from \$100,000. The resultant number is the amount the subcontractor “gave up.” Then, whichever party “gave up” the smallest quantity is the winner. For example, if the subcontractor takes \$75,000, the owner pays \$40,000, and the contractor pays \$35,000, then the subcontractor essentially “gave up” \$25,000 (\$100,000 - \$75,000) and would be considered the winner because that team lost the least amount of money among the three parties.



- iii. At the mentors' option, the winning team can be awarded a simple prize once the winning team is identified. Because this method also calculates degree of win, one winner can also be determined among several different independent negotiation groups. The overall winner would be whichever team gives away the lowest dollar value. If awarding multiple prizes, the winning team in each negotiation should be given consideration.



**C. Final thoughts: What is negotiable? How can you apply what you learned today to everyday life?**

- i. Don't be afraid to ask if the price is negotiable.
- ii. When something is negotiable, be reasonable with your expectations. Typically, you cannot make someone go below cost, so only the markup on the product or service is negotiable.
- iii. Buying in large quantities may entitle you to more of a discount.
- iv. Be creative. If you cannot lower the price, you might throw in other items or future business.
- v. No agreement is called an "impasse."
- vi. Consider your alternatives if you reach an impasse:
  - 1. BATNA (Best Alternative To a Negotiated Agreement)
  - 2. WATNA (Worst Alternative To a Negotiated Agreement)
    - a. Increased attorney's fees and costs.
    - b. Inability to work on additional projects due to lack of funds.
    - c. Time and expense of litigation.
    - d. Dispute will be decided by a judge, jury or arbitrator, leading to the different parties losing control of the dispute.

#### IV. Optional Mentor Mock Negotiation (10 to 15 minutes)

- A. If time permits, 3 mentors can each play the role of a party in the same negotiation scenario the students just completed.

Spend 10 to 15 minutes letting the students observe how others negotiate.

- B. Mentors should try to get across several concepts, including:

- i. Stay calm and collected; negotiate without being loud, yelling, or irritating. When students have previously observed mentors negotiate, they are surprised by how the mentors disagree with a cordial and professional manner. (Students will often get worked up with emotion when they negotiate.)
- ii. Stay focused on the issues, making arguments and avoiding personal attacks.
- iii. Move to discussing dollars; either prompt an offer from the other side (e.g., “that’s not reasonable, how much would you be willing to take?”), or volunteer one yourself (e.g., “what if I offered you XX?” or “I realize I had my own problems, what if I came down to XX?”)
- iv. Force the other side to make concessions when you make a concession; make them match your movement. If they reject your offer, do not just throw out another lower/higher offer; get something out of the other side first to move towards a resolution.





*(For all students)*

## General Negotiation Scenario

This dispute involves the construction of a school. It is to be a 3-story building with a basement.

### The Parties

The School District (Owner) is the party that wants to build the school.

ABC Construction (Contractor) is the party hired by the School District to build the school.

The Contractor then hired Big Dig Excavation (Subcontractor) to perform the excavation portion of the work at the Project.

### The Contracts

School District → Construction

The School District hired ABC Construction pursuant to a lump sum contract (the Prime Contract). A lump sum contract means that the Contractor agrees to build the whole school as shown on the contract drawings and specifications for an agreed upon price.

ABC Construction → Big Dig Excavation

ABC Construction hired Big Dig as a subcontractor on a time and material basis (the Subcontract). Time and material means the Subcontractor is paid for the work it performs on the project, in other words, per hour of work.

### The Project Details

The building's basement consists of concrete foundations and footings. The footings were to be 20' below grade to accommodate the basement. This is new construction so excavation was required.

The Prime Contract specifies that the Contractor must dig until it hits rock. The Prime Contract also says that the excavation depth at which hard rock exists is to be determined by the Owner's Engineer of Record. The Prime Contract drawings showed that at 20' below grade, rock would be strong enough to support the footings.

### The Problem

The Subcontractor started excavating the soil. When it reached 20', it discovered that the rock at the 20' elevation was not suitable (too soft) to install footings. As a result, the Engineer of Record required the Subcontractor to excavate another 5' of dirt than originally shown on the Prime Contract documents to reach hard rock. It took the Subcontractor an additional two weeks to remove this extra 5' of soil.

The Subcontractor submitted an invoice to the Contractor for \$100,000 for the additional excavation cost. The Contractor passed the invoices on to the Owner for payment. The Owner rejects the additional costs, and a meeting with all parties is arranged to discuss and possibly settle the issue.

**PRIME CONTRACT BETWEEN THE SCHOOL DISTRICT AND ABC CONSTRUCTION, INC.  
TO BUILD A SCHOOL AT 123 SCHOOL HOUSE ROAD**

**THIS PRIME CONTRACT** is made this day of \_\_\_\_\_ between **The School District** (hereinafter referred to as “Owner”), and **ABC Construction, Inc.** (hereinafter referred to as “Contractor”), for the construction of a 3-story school with a basement.

*Owner and Contractor for the sum identified below, agree as follows*

- 1. **Contract Documents.** This Prime Contract along with the drawings and specifications, prepared by Rock Solid Engineering, Inc., attached hereto as Exhibit “A”, shall be considered the “Contract Documents.”
- 2. **Scope of Work.** The Contractor will perform all work necessary to complete the construction of a 3-story school with a basement in accordance with the Contract Documents (the “Work”). In order to complete the Work, the basement shall consist of concrete foundations and footings. Contractor is required to excavate to ensure that all footings are supported by hard rock. Contractor shall complete the Work in strict accordance with the Contract Documents.
- 3. **Time of Completion.** Contractor shall complete the Work within one year from start of the Work.
- 4. **Contract Sum.** The Owner shall pay the Contractor for the performance of the Work in the guaranteed lump sum of \$3,000,000.00.

This Prime Contract is executed the day and year first written above.

**The School District**

**ABC Construction, Inc.**

BY: \_\_\_\_\_

BY: \_\_\_\_\_

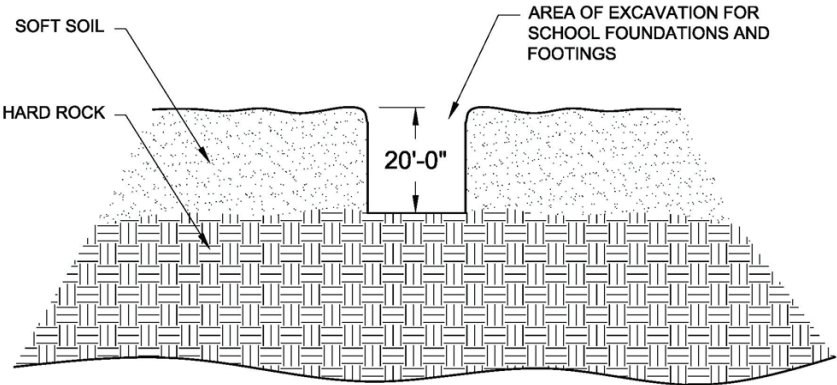
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**Exhibit “A”**



**SUBCONTRACT AGREEMENT BETWEEN ABC CONSTRUCTION, INC. AND  
BIG DIG EXCAVATION, INC. FOR WORK AT 123 SCHOOL HOUSE ROAD**

**THIS AGREEMENT** is made and entered into this day of \_\_\_\_\_ between **ABC Construction, Inc.** (hereinafter referred to as "Contractor"), and **Big Dig Excavation, Inc.**, (hereinafter referred to as "Subcontractor"), for the performance of excavation work at the project located at 123 School House Road ("Project") owned by the **The School District** ("Owner").

*The Contractor and Subcontractor agree as follows:*

1. **Contract Documents.** This Subcontract and the agreement between Owner and Contractor (the "Prime Contract") shall be considered the "Contract Documents".
2. **Scope of Work.** The Subcontractor will perform all work necessary to complete the excavation of the soil at the Project in accordance with the Contract Documents (the "Work"). In order to complete the Work, Subcontractor is required to excavate until it reaches hard rock to allow the Contractor to install footings.
3. **Time of Completion.** Subcontractor shall complete the Work within eight (8) weeks from start of the Work.
4. **Basis for Payment.** The Contractor shall pay the Subcontractor the costs (time and material) necessarily incurred by the Subcontractor in the performance of the Work ("Cost of the Work"), plus the Subcontractor's fee of ten percent (10%).

This Agreement is executed the day and year first above written.

**ABC Construction, Inc.**

BY: \_\_\_\_\_

PRINT NAME: \_\_\_\_\_

TITLE: \_\_\_\_\_

**Big Dig Excavation, Inc.**

BY: \_\_\_\_\_

PRINT NAME: \_\_\_\_\_

TITLE: \_\_\_\_\_

*(Only for eyes of Owner team)*

## **Negotiation Strategy for Owner (School District)**

### **Your Strengths**

You have a “lump sum” contract with the Contractor for all work associated with the construction of this building, including the excavation for the foundations and footings.

The Prime Contract specifies that the Contractor must excavate to a depth at which hard rock exists. You believe that by agreeing to complete all of the work for a lump sum, the Contractor took a risk that if it had to excavate deeper than the 20' listed on the drawings it would be responsible for the extra costs.

### **Your Weaknesses**

The note by the engineer you hired on the drawings indicates hard rock at 20'. You are concerned about this note because it conflicts with the Prime Contract, and you believe you may have some responsibility. However, you are already near going over budget and believe the Contractor had to excavate until it hit hard rock as per the Prime Contract.

You also believe the Subcontractor was slow performing the work and do not think you should have to pay for any additional work/time because of the Subcontractor's own problems, especially when you have a “lump sum” contract.

### **Your Negotiation Position**

Your goal is to pay as little as possible. You estimate that you can pay up to \$45,000 without blowing the school district's budget. Your boss said, “you need to make a deal by close of business today.”

*(Only for eyes of General Contractor team)*

## **Negotiation Strategy for General Contractor (ABC Construction)**

### **Your Strengths**

The Prime Contract specifies that you must excavate to a depth at which hard rock exists as determined by the Owner's Engineer of Record.

The Owner's Engineer of Record noted in the drawings that hard rock exists at 20', and you relied on only having to dig down 20' when pricing how much it would cost you to excavate the Project.

### **Your Weaknesses**

The Prime Contract simply says that you must excavate until you hit hard rock and does not limit the depth of excavation to the 20' determined by the Engineer on the drawings. By agreeing to a "lump sum" contract with the Owner for all work associated with the construction of this building, including the excavation for the foundations and footings, you may have taken a risk that if a problem like this arises you have to bear the expense.

You are concerned that the Prime Contract may supersede the note on the drawings showing rock at 20', leaving you stuck with the additional costs incurred by the Subcontractor.

You have a different type of contract with the Subcontractor. You have agreed to reimburse the Subcontractor on a "time and material" basis regardless of how deep the rock existed at the Project.

### **Your Negotiation Position**

Having successfully worked with this Owner in the past, you do not want to dig in too hard in hopes of obtaining additional work. You do not want to be the one responsible for losing a regular client. However, you have a tight budget and cannot give away cash.

You were not happy with the Subcontractor's performance of this work. The Subcontractor was slow due to constant equipment malfunctions and billed you for periods of time that its workers were sitting around because its equipment was being fixed. You believe it should cut its price accordingly since it billed you for time that it was not working.

Your goal is to pay as little as possible. Even though you believe you owe nothing and that the issue is between the Owner and the Subcontractor, you have up to \$45,000 to contribute and make this problem go away. This amount allows you to break even. Any less will increase your bonus! If you pay over that amount, you will be looking for another job.

Your boss said, "You need to make a deal today!"

*(Only for eyes of Subcontractor team)*

## **Negotiation Strategy for Subcontractor (Big Dig Excavation)**

### **Your Strengths**

The Subcontract was on a “time and material basis” not a “lump sum.” You performed the work and submitted the time for payment per your Subcontract. You have paid your workers already for the work they provided.

### **Your Weaknesses**

During the project, you suffered from equipment malfunctions that the Contractor and the Owner may claim caused you to take longer than it should have to complete this extra work. While you insist that these equipment problems were typical and were part of everyday construction, you know there were long periods where your equipment was not working and your workers had to sit around and wait for it to get fixed. Part of this time occurred after you would have been finished had the hard rock been 20’ deep. You submitted an invoice to the Contractor for reimbursement for all of your time including the time your workers were sitting around.

### **Your Negotiation Position**

This is your first job with this Contractor and Owner, and you are willing to give in a little if it means getting more work in the future.

Your goal is to reduce your invoice by as little as possible. You have looked at your costs. A break even for you would be to forgo profit and markups and take only \$55,000 out of your claimed \$100,000. Any less means temporarily laying workers off. More means holiday bonuses may finally be possible this year.

You need to make a deal today so you have enough money to cover your next payroll!





# Construction Contract Negotiation

American Bar Association  
Forum on the Construction Industry 2013

Career Directions for Students in Architecture, Construction and Engineering



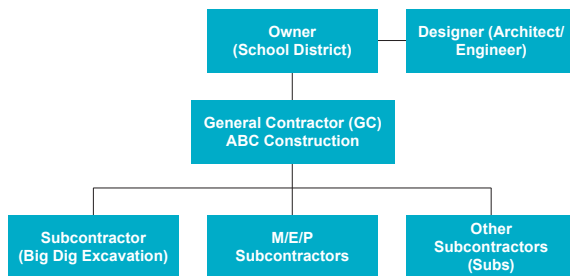
## Sources of Law

- **Contract Terms**
- **Common Law**
  - Prior decisions, e.g. Spearin v US
- **Statutes and Regulations**
- **Dispute Resolution**
  - Negotiation/settlement
  - Mediation
  - Litigation (Court System)/Arbitration

Career Directions for Students in Architecture, Construction and Engineering



## Parties on Construction Project



Career Directions for Students in Architecture, Construction and Engineering



## Negotiation Tips

- Use your arguments
- Start low/high
- Take breaks/talk with your team
- Explain Position

Career Directions for Students in Architecture, Construction and Engineering



## Basic Elements of a Construction Contract

### Essential Terms of Contract

- Price
- Scope of Work
- Duration

### Typical Payment Methods

- Lump Sum (low bidder)
- Cost of Work Plus a Fee (Time and Materials)
- Cost of Work Plus a Fee with a Guaranteed Maximum Price (GMP)

Career Directions for Students in Architecture, Construction and Engineering



## Negotiation Module

- \$100,000 Construction claim from Subcontractor to General Contractor to Owner
- Three-party negotiation
- Read common fact pattern and contracts
- Read your party's sheet
- Meet with your teammate(s) (15 minutes)
- Meet with other parties to negotiate claim (30-45 minutes)
- Sign paper with settlement terms

Career Directions for Students in Architecture, Construction and Engineering