



Podcast Transcript

Construction Litigation Unveiled: Navigating Disputes in the Built World

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Lee: As construction projects become more intricate and expansive, the window for disputes has widened. Rushing projects into construction phases has led to contract document errors and omissions emerging as the key source of legal conflicts within the last year. I'm Leanne Lee, and you're listening to BakerHosts.

On today's episode, we will dive deeper into the world of construction lawsuits and the factors that are contributing to the increase in those lawsuits, from the COVID-19 pandemic causing labor shortages, supply shortage, and elevated material costs, to avoiding pitfalls and force majeure claims and industry adaptations. Joining us today is Michael Cortez. Michael specializes in representing real estate owners, architects, contractors, and energy companies in complex commercial and industrial construction projects. He has extensive experience negotiating construction contracts and is a frequent author and speaker on construction law topics. Michael, welcome to the show.

Cortez: Thank you. I'm glad to be here.

Lee: So, to get us started, according to the Arcadis 13th Annual Construction Disputes Report, the average value of a construction dispute has doubled between 2016

and 2019, culminating in \$42.8 million by 2022. What are the key drivers behind this dramatic escalation?

Cortez: Thank you for that question. Yes, the report itself, I think, is a really valuable tool for construction and real estate industry participants. It really kind of shines a light on kind of what is going on in the industry, and I find it extremely valuable. In fact, when I used to teach at the University of Houston, I taught a class in construction contract administration, and we would go through this report every year. Because I think it does have really good tools and lessons for everyone to kind of pay attention to as to the pulse of the industry as to what is going on in construction and in disputes and how to get around those and how to really navigate them.

The title of the report in and of itself is called Embracing Change, and it uses the phrase, quote-unquote, new normal and we've heard that term a lot during the pandemic and the post-pandemic. And I think this is really reflective because this report is the first one that really reports on what was going on for projects, were either in the middle of their building process or had just started during the pandemic. So, it really is an interesting report.

And as you mentioned, the value of the reports is actually the highest it's ever been recorded in the 13 years of this report. And it is an increase of 42%, which is pretty significant. In fact, I was just reading a headline the other day about, and I'll quote it, it says, multi-family developers experiencing construction delays spiked to 90% in Q2 of this year. And I had to read that headline a few times to make sure I was reading it correctly. But that is what it said, and I think these are just things that we're going to continue to have to grapple with moving forward, and basically, this roller coaster ride that we've been on during COVID is not over. And so, this is really reflective of the new normal that we keep talking about.

And in fact, the key drivers that you mentioned, or asked about, are cited in the report, really directly, at the overall dispute causes. Number one, errors and omissions in contract documents; second, owner-contractor subcontractors failing to understand and/or comply with the contract; and three, poorly drafted or incomplete or unsubstantiated claims. So, kind of what is driving all that? Well, and we'll talk in much more detail later on, but essentially it is an increase in owner expectations. Basically, faster jobs on budget. That is what I mean by owner expectations. And just like everybody else, another key driver is inflation and supply chain issues. Late deliveries of materials and supplies, and also the increase in cost of those from the time they're ordered to the time they have to be paid for or brought to the job site.

And just to kind of emphasize, the failure to understand the contract is, I think, a really key point. It is a frequent factor in every survey that I've read that's come out every year is the failure to understand and comply the contract, which as a construction contract or transactional lawyer, this is close to my heart, and it is extremely important. So, understanding your contract is also, you know, a very

important issue to make sure that we understand those requirements in the contract.

Lee: Okay, great. So, you mentioned speed. So, how has the race to expedite construction projects and manage costs led to an increase in the frequency and impact of construction lawsuits?

Cortez: Yeah, it is really kind of pretty basic. As I mentioned, you know, this is a problem as old as time in the construction world. Getting something built on time and under budget, whether you're building a pool in your backyard or a \$500 million commercial office building or apartment building, or whatever it is, that is really, and I tell everybody, clients and students when I was teaching, was these are really the two most important things on a construction job other than safety. Obviously, safety is number one, but everybody's key concerns is getting it built on time and under budget. And so, you have these sort of competing issues that are kind of happening right now in the industry, which are these runaway costs and pressures to build faster, and those have led to spikes in disputes.

For example, I saw a recent report about hotel construction timelines shortening from 10 to 12 months to between eight and 10 months. And while that doesn't sound like a lot, it is a lot when you're trying to compress or shave, you know, two to three months off of a construction project of that complexity and that size. And because ultimately, for owners, faster to market means faster revenue stream to get your money back for the cost to build a project. And also, for contractors, they're trying to get things done faster as well to reduce the inflationary and supply chain delay pressures.

During COVID, I remember when I had clients calling me about this, a lot of contracts got put on hold thinking that, okay well, this is, I remember when COVID first came out, it is like, oh, it is going to be two weeks. Well, it ended up being two years, but at the time, people put projects on pause thinking that, well, if we just wait this out. Well, it just got worse. And so, people kind of learned, I think, from that lesson of well, waiting is not going to really solve the problem. It is just going to make it worse. So that led to more of a mindset amongst owners and contractors of no, we just got to go faster. And so, I think that is part of this race to expedite and try to manage this sort of perfect storm, quote-unquote, of inflationary issues, supply chain, and all these other things that have happened in the industry over the past two or three years.

And in fact, in the report it cites that 30% of projects report impacts due to price escalation or inflationary pressures, as well as supply chain, and this is still lurking. This was probably the first thing that I saw in COVID, was the supply chain issues and getting elevators, switch gears, generators, transformers, what we call long lead items, things that take a while to get to the job site to be either, they have to be fabricated or manufactured off site and then brought to the site. Well, that is a time-consuming process.

And in fact, during COVID I also recall I had a client who's building a multi-family apartment building. And the last thing they usually to go in apartment buildings is

the cabinetry. Well, they had special ordered these cabinets from Italy. Well, Italy was already locked down. And so that really caused an issue of trying to get these cabinets, or getting an alternative source for these cabinets, to get the project finished because literally that was one of the last things to get the project done. So, that is really kind the nutshell of how all these pressures and time pressures and cost and delays kind of have spiked the lawsuits and disputes around all these issues.

Lee: That is really interesting. Let's dig into that a little bit more. So, we know COVID-19 has been a catalyst for construction disputes through supply chain disruptions, higher material costs, and labor shortages. So, how have these challenges triggered disagreements among landlords, developers, contractors, and subcontractors?

Cortez: Great question. That is really kind of the ultimate issue as to the disagreements. How do they get there? Disagreements can take many forms in the construction industry. It doesn't necessarily have to lead to litigation. It usually just is disputes over change orders, disputes over costs, and disputes over delays and things like that, that kind of slow down the process. But it doesn't necessarily lead to litigation. It can and sometimes does but, you know, like for me, my goal is to prevent the litigation from happening. And so, and they're very common, disagreements are common on construction projects. That is really never going to change. It just, kind of the nature of the beast, so to speak. But really what you do about them in real time determines the impact on your construction projects.

And so, while COVID issues are waning somewhat, however, as of today's recording, there's been an uptick in COVID cases going into the fall, and so it is just, I think this is going to be an annual kind of thing that we're just going to have to deal with as far as COVID, at least the specific issues with COVID. And there's been a lot of legislation and things in different states that have attempted to deal with this, in context of the construction industry.

But you have, in addition to COVID, you have other issues that have arisen post-COVID that are also kind of impacting or increasing these disagreements that we're having to kind of deal with. You have environmental concerns due to climate change and changing building methods. A lot of owners and counties and cities in certain jurisdictions are or have sustainable building methods requirements, and things like that. ESG concerns and requirements and issues that have to be addressed in the contract as well as in the actual procurement and construction of the project. You also have other issues like modular building, prefabrication, 3D printing, those sorts of things. All those things are kind of coming into play and leading to different ways and challenges in building projects these days.

Not only that, then you have the continuing pressures of price escalation and supply chain issues, but you know, you have this force majeure claims continue to trigger disputes. That was probably one of the most common questions within the, in 2020 and 2021, I almost got calls on that on a daily basis. What is force majeure? How do I address it? Are we permitted to have force majeure? Is it

implied in my contract? Is it not implied in my contract? It is a very sticky question, depending on what, which jurisdiction you're building in or you're governed by. That is a continuing issue that I think will always kind of be around and I think that is, COVID really challenged us in the construction industry to really address that properly and specifically in your construction contracts.

So, for example, why all these have triggered disputes, this perfect storm that I keep talking about, is really how these issues are or not addressed in your contract or your design contracts. As I mentioned, you know, who pays for the price increases if the price goes up? Do you allocate that risk? Does one party take on that risk, or is there some sort of mitigation efforts to try to balance those risk allocations of the price? And as I mentioned, what is or is not a force majeure? I've negotiated that 'til the cows come home, as we say in Texas. The force majeure is really important not only to say what it is, but also what it is not. Because the short story is most of the states, force majeure is defined really by what is in your contract. There is very few states that have an implied force majeure, so you have to be really careful about that.

And what happens if there is a shipping delay? Who is responsible for ordering the items and when? As I mentioned, the long lead items. When, you know, who is responsible for ordering those and who should bear that risk? Increased pressures to finish faster, like I mentioned, is also increasing the spotlight on liquidated damages. That is another thing that has really been triggered by all this, is disputes of liquidated damages. And what are those? And essentially what those are, they're costs or per diem charges that a contractor is charged for finishing a project late. That is kind of the real short answer as to what liquidated damages are, but they're also very misunderstood. How much are they? How should they be calculated, and when is a party responsible, or not, for liquidated damages? That issue has really been triggered by all these issues that have been come up during COVID is liquidated damages. I'm seeing more and more disputes about liquidated damages.

So, the bottom line, really, is your contract needs to address as many of these potential and likely sources of disputes, otherwise it just becomes a dispute that you have to deal with while your project is being built. And that costs, as I mentioned, time and money. And so, how you address those in your contract, to me, is really key to try to prevent these issues from triggering disputes.

Lee: Great. So, let's switch gears here for a second. As construction projects become larger and more intricate, the space for disputes has grown wider. So, how can stakeholders effectively manage these complexities and mitigate potential conflicts?

Cortez: Yes, I mean, as I mentioned, construction disputes are common in the construction industry. And they're just like any other industry really is, you know, when there are good times, there is a lot of projects going on, everybody has a good backlog of contracts and projects to go work on, the disputes go down. But when there is a slowdown in the construction activity, like there is now due to increase in interest rates and things like that, I'm hearing a lot of projects are on

pause. That slow-down, well, disputes go up because every project starts to count more. Every dollar counts, that sort of thing.

So, in my opinion, the best way to really mitigate this, and the report reflects this, is a thought-out process to resolve disputes. How are we going to do this? And how you do that is through risk management plans, getting ahead of long lead items, as I mentioned, the elevators, the switch gears. Who is responsible for ordering those when, and discussing with all the parties, all the alternative building methods such as, as I mentioned, you know, sustainability, modular building, prefabrication, getting Italian cabinets from San Francisco rather than Italy to try to reduce the shipping delays, things like that. In a clear dispute clause in your contract, how do you handle those when they come up? What do we do? Do we have, do we set up a meeting? Who is responsible to be at the meeting? How, who sends the notice? Those sorts of things. So, negotiate and discuss key contract terms around these issues. That is really the key.

And as I tell clients on these sorts of things, communication, communication, communication. Early and often. If there is an issue, someone needs to raise their hand sooner rather than later because in, you know, just like anything else, project disputes or problems don't get better through time. They, 99.99% of the time, get worse. So, the earlier you raise the red flag with all the participants and try to come up with some sort of collective solution, that really kind of is key.

Lee: And I have one last question for you. You know, we've talked a lot about timing and rushing projects into the construction phase has proven to be a source of legal conflicts, primarily due to errors and omissions in contract documents. So, could you elaborate on the impact of these document discrepancies on the industry and some potential solutions to curb this trend?

Cortez: Sure. Yes, this is another timely topic for me because I've been getting a lot of calls from clients on these issues about errors and omissions and design requests and things like that, and how do you deal with those. Errors and omissions has been a top three cause of construction disputes in this report for the past seven of nine years. So, it is not going away, and it is a common issue. And it is a definitely strong trend in that it is not, it is really not going to change anytime soon. And this increase in owner expectations along with these faster timelines, with larger, more complex projects are really the key drivers of this trend of these, what leads to errors and omissions.

So, rushing through these plans to try to get things to start building quicker and finished faster leads to a little bit of a rush to get these drawings and plans done. Which, as you can imagine, leads to potential errors and, or at least discrepancies when the drawings or the plans are done. And that leads to confusion and increase in the, what we call the RFI process, or the request for information, that a contractor has to raise their hand and say, hey, there is a problem. I think there is a problem here, you need to ask the architect or the engineer what they meant by this or meant by that, and that just slows down the process of the actual construction. And so, really, who is responsible for those delays? You know, when a contractor has to stop and ask for clarification on

errors and omissions. Is it the architect? Is it the owner? Is it the contractor? You know, should the contractor have seen these errors sooner and let the owner or the architect know so we're not stopping in the middle of the jobs. That process and the lack of coordination between the parties is really kind of the key issue that comes out of these errors and omissions.

And, for example, an electrical engineer I know, which happens to be my father-in-law, was telling me about a job that he was working on, and he was building this project and he was looking at the plans. And they were at the job site, and I still remember him telling me this, and he is looking at the plans and there is no plugs. There, no one drew the plugs for this building or this floor, and they had to go back and redraw them and put them back in there, because that leads to this cascade of issues of, okay well, there is no plugs. Okay well, there is no lines to put the plugs in the wall. And so, it just sort of leads to all these different issues and claims.

So, what can we do about it? As I mentioned, early communication, it starts with all the parties. And as the report says, the three most effective claim avoidance techniques are number one, risk management program, which we've talked about; number two, contract and specifications reviews; and three, constructability reviews. And all those really, to me, are almost the same thing because they're really, to me, about the parties getting together and coordinating as much as they can to get to, to reduce at least the amount of errors and omissions.

Another way that they've tried to do this is also using different, alternative delivery methods like design-build, or what we call CMAR, Construction Manager At Risk, which the design-build is where the contractor is also responsible for the design. So, it's been known to lead to faster, more and more coordination between the architect and the builder because they're the same entity or the same, under the same contract with the owner. And CMAR, the Construction Manager At Risk, the contractor is more involved in the design process than in the normal construction method.

And lastly, there is also, very important out of this survey, they cited three most important factors in mitigation or early resolution of disputes is one, the owner and contractor willingness to compromise; number two, accurate and timely schedules and reviews by project staff or third parties; and number three, contractor transparency of cost data and support of claimed damages. So, and owner willingness to compromise, that is important because I saw a lot of that during COVID was, there was a lot of things that weren't addressed in the contract. Obviously, the projects that were going on during COVID didn't have COVID in their contracts. So, it just took some willingness from both sides to, well, the contract doesn't say this, that, or whatever, but we need to try to figure out a solution to this problem.

So there has to be some willingness on both sides to bend a little bit or compromise, and I do strongly agree with that, that I think that is a really important way to mitigate and come to an early resolution of problems is to do

that. So, for me, the bottom line of all this is draft and negotiate better contracts that fairly allocate risks. So, in other words, who should bear the risk, and address as many of these as you can that we've talked about today in this annual Arcadis report. And as I tell clients, the best insurance is an adequate investment of time and money up front before the shovel hits the ground. You know, review the plans, come up with a risk management plan dispute process. And as I mentioned, negotiate and come up with a fairly balanced contract with your internal or external lawyers. It is just, it is worth that investment to try to reduce the amount of disputes that you're dealing with during a construction project.

Lee: Well, this has been great, so much to think about. Thank you, Michael. And if you have any questions for Michael, his contact information is in the show notes. As always, thanks for listening to BakerHosts.

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