



# CH-CH-CH-CH- CHANGES:

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## ONE CONTRACT AT A TIME

JUANITA F. FERGUSON

**C**hange involves risk. While that concept may be accepted and even celebrated in certain industries, most construction professionals would agree that the successful management and completion of a construction project is dependent in large part on eliminating as much risk as possible. Workplace safety notwithstanding, change orders can and do present most of the notable risks for a construction project. Change orders are dynamic and can include uncertainty related to increased costs for an owner; threats that a contractor may experience in its ongoing relationship with an owner; and administrative adjustments that accounting personnel must make to account for the variations on an original agreement. It is possible, however, to reduce much of the uncertainty that abounds with change orders by not only embracing their

mechanics but negotiating and taking command of issues that can and do cause the change order process to spiral out of control.

A change order has the same meaning irrespective of the size of a construction contract. It is a written order representing work either added or deleted from the original scope of work, issued after the owner and contractor enter into an agreement and signed by both parties. A change order does not invalidate a contract but, by its very name, alters a contract in some form. Often, it results in an increase to the original contract amount, although there are circumstances in which change orders could actually decrease the amount. Another common outcome of a change order is that the time to complete a contract is extended. Even if the contract amount or the time to complete the contract is unchanged as a result, the implementation and execution of a change order signals that the parties to a contract accept some evolution in the owner-contractor relationship.

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## Why the change?

Change orders occur on a majority of public and private construction projects. One of the main reasons is that an owner's needs or wants may change after a contract is executed. It could be that the contractor makes an unrealistic cost assessment at some stage of the project. Necessary work may be done without approval due to miscommunication with the owner or in an effort to complete a project already behind schedule or plagued with work quality issues. Other reasons for change orders include changes in jobsite conditions; an increase in the costs of materials, labor, or equipment; the surfacing of regulatory issues; and safety concerns that may arise and need to be addressed after a project is underway. Unforeseen circumstances are also often a factor in the need for change orders.

## Errors and omissions

Ask a general contractor if addressing errors and omissions on a project is expected, and more than likely the answer will be in the negative. Whether it is wishful thinking or historical data that supports the statement, between the design and the construction phase of a project, there is always a possibility that some error may result. If the error is contractor based and the contractor agrees to assume any additional cost associated with the error, a change order still needs to be issued to allow for any extension of time that is necessary to address the contractor error. If the design professional is the cause of the error, and the error either is not or cannot be detected until construction has commenced, the change order is still vital to ensuring that the parties agree how to proceed.

## Differing site conditions

Differing site conditions present particular challenges in the managing of change orders. Whatever the conditions may be on a project, they should be clearly noted in the contract documents. If certain aspects of the jobsite cannot be observed fully until excavation occurs, it may be that an adjustment to the contract amount or the time to complete the job is appropriate. To prevent a change order dispute with an owner, a contractor

should notify an owner and the design professional before the conditions are disturbed.

Sometimes, a contractor does not have the luxury of waiting for formal approval from an owner before unilaterally addressing an issue that will later become the subject of a change order request. Life-threatening circumstances or situations on a jobsite could cause imminent harm to people or the owner's property, which, if left unattended by a contractor, could have catastrophic consequences. Software is now available to allow the sharing of information at a construction site in real time. If constant access to the site is not provided for in a contract or financially feasible for the particular job, a contractor could be put in the unenviable position of being unable to notify an owner in advance of correcting a harmful situation. In those circumstances, the prudent action would be to document the condition (by either photo or video) to provide evidence so that, when an owner is presented with a change order request, there are no doubts about the need to respond to the contractor. Even having taken those steps, it is important not to procrastinate in formally requesting and updating the changes to the contract.

To minimize uncertainty if the parties cannot agree on the requested change, obtaining a third-party arbiter is a term that should be included in a construction contract. Whether it is an owner's architect or another party that the owner and contractor can agree will be impartial, knowing in advance who to turn to is an effective tool for resolving a change order dispute.

## Third-party issues

The source of change orders is not always limited to the parties to a contract. A change initiated by agreement of an owner and a design professional is referred to as a construction change directive. The architect makes a determination of an amount due as a result of the change for the purpose of certifying a contractor's application for payment. If an architect is routinely involved in the construction process, the parties should include a provision in the agreement detailing that a good faith estimate of the change to the time and/or amount of the



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contract (pending resolution of a change order) will be provided, should the contractor dispute the amount. Once the owner and contractor reach agreement on changes to the contract amount or an extension of time to the contract, the architect can then prepare a change order.

Change orders may also be instituted to respond to building code changes that occur during the life of a project. If the applicable code does not grandfather the condition, then the change order should be executed not only to protect the parties from government sanctions, but also to acknowledge whatever variances on the project are due to updates to a building code.

### **Underestimating what you do not know**

There is no room for not knowing when preparing a construction bid. It is no secret that far too often bids are prepared without full access to plans. Maybe a contractor has no insight on the design and is working from owner-provided plans. If a change

order is required due to a design error, it could put an owner at risk for dealing with increased contracting costs.

It is not uncommon that the parties agree or expect to revisit certain details of the agreement after work begins on the project. That is a prescription for needing to issue change orders. It is best to avoid entering into a contract without accounting for the full scope of a project.

### **Document, document, document**

Any savvy party to a contract is going to ensure that there is plenty of documentation from the project's beginning to its end. Memories of the parties may fade, and lack of a paper or digital trail is just poor business. That said, it is important not to confuse a large amount of documentation with effective change order documentation. Emails and texts are insufficient substitutes for a formal change order, although this is less of an issue for larger projects. A solution to address improper change order documentation is to invest in change order software. This

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way, both parties can get instant updates on the status of change orders.

Large and small contracts alike have a provision that change orders must be presented in writing. In fact, most jurisdictions make this a legal requirement. However, the reality is that while change orders are agreed upon, they sometimes remain unexecuted due to a delay by one or both of the parties. In some cases, time passes and the change order is not properly documented while the parties still have a firm grasp of the reasons for the change order. Contractors proceeding with work without the benefit of a signed change order do so at their own peril, and an owner who refuses to pay due to lack of a written order proceeds at the same peril. If the parties find themselves in litigation, lack of documentation makes it more challenging to seek relief. The finder of fact is unlikely to be sympathetic, since the requirement of written change orders is included in most, if not all, contracts, either by law or as a term of agreement between the parties.

### **Why it is important to manage change orders**

Allowing change orders to go unmanaged is not a good business practice. The contractor could experience a loss in revenues, or a breakdown could occur in communications between the parties. If the scope of work is poorly defined in the contract, the potential for misunderstandings (and the need for change orders) is almost guaranteed from the start of the project.

A key source of the confusion surrounding change orders is the amount owed by the end of the contract. Whether a change order results in credits or additional costs, it should be carefully monitored, and not just by those in the field responsible for effecting the change. A good project manager ensures that a contractor's accounting department is kept abreast on the status of a change order. Additionally, subcontractors should be required to follow the same methodology when evaluating their own change order requests. The more stakeholders participating effectively in the process, the better the opportunity to manage.

### **Leveraging change**

The process that results in a signed change order is nothing more than an extension of the way in which the parties negotiate the contract. The parties should treat the review, the execution, and the implementation of a change order in the same manner as an original agreement. First, before presenting a change order request, the contractor should compare the contents of the request to existing contract provisions. That will avoid duplication of terms already agreed upon, such as type of materials, the labor rate to fulfill the change, and the time to complete the change.

Regardless of which party initiates the change, do not fear pushing for favorable terms. A contractor and an owner have an incentive to reach agreement once a project is in progress. For an

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owner seeking to maintain an advantage, consider including a provision that a contractor waives rights to any additional costs other than those included in a change order. The risk for the contractor in agreeing to such a term at the start of a project is that it fails to consider the impact on loss of productivity, overhead costs, or any other indirect costs due to the change order.

In the original agreement or change order, a contractor may consider trying to reserve as much right as possible to future claims for costs or additional time based upon a change order. With such broad rights reserved to the contractor, if an owner fails to analyze the change order, it may set itself up for additional change orders in the future to address issues resulting from the original change order. The goal is for both parties to negotiate so that the executed change order is one that reflects equal input.

### **Accounting concerns**

Approved change orders are the optimal scenario for proper accounting. There is a greater likelihood of payment, and the possibility of overstating revenues is also minimized. A contractor can include the

full price of approved change orders in the contract price, assuming the realization and collection on the change orders is probable.<sup>1</sup>

### **Final thoughts**

Either party in a contract has the ability to alleviate some of the uncertainty surrounding change orders. Owners should not hesitate to request backup in support of a change order or compare costs for

materials and labor to the original contract. Contractors should consider change order management software to automate the approval process of change orders. Revisiting the original plans frequently will remind all parties to come to an agreement that reflects the original vision of the project. ■

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### **NOTES**

<sup>1</sup> Vasquez, C., "The basics of change orders and change order management," Aronson, LLC (Oct 7, 2015) (blog post).