

Maximize Your Leverage When Discussing Change Orders

Change orders are a fundamental part of doing business for many construction subcontractors and material suppliers. They are directives for work to be done or materials provided outside the original scope of a contract. It is rare for a project to be completed without any changes. An average of 35% of projects experience at least one major change, according to an Independent Project Analysis Group study.

The top five effects of change orders are listed as cost overrun, time overrun, disputes between parties to the contract, quality standards enhanced and complaints of one or more of the parties to the contract, according to the study, *Evaluation of Change Management Efficiency of Construction Contractors*. It also finds the average cost overrun due to change orders is between 11% and 15% of the original contract value in large building construction, while the average schedule overrun is between 10% and 20% of the original project duration.

Change orders, however, provide owners and general contractors with flexibility to address unexpected occurrences. For example, an original contract calls for an LED lighting upgrade in a gymnasium at a local high school. The contract value for this project is \$100,000. After the original contract has been signed, the school decides it would like the light poles in the parking lot updated to LED as well. The cost of this project will be an additional \$25,000. In this case, the contract should require a change order calling for the additional work, cost and time associated with LED lights in the parking lot.

Despite being commonplace, change orders also create some of the biggest points of contention and additional costs, including legal fees. To minimize the aggravation and associated costs, it is important to manage and execute them properly to avoid disputes and ensure payments are timely.

Types of Change Orders

The original contract for a project should clearly define the scope of work so it is clear what is included in the contract and what is extra. Change orders occur when the original scope of work changes. As a result, these changes commonly affect deadlines and price.

There are two basic types of change orders: additive changes, which increase the scope of a contractor's work; and deductive, which reduce it. Whenever the original contract is amended, a written change order should be created. Well-documented change orders help you get paid faster, preserve customer relationships, reduce disputes and stress, reduce or eliminate legal fees or delays, and provide documentation in a lien or bond claim situation.

What Should a Change Order Contain?

Change orders typically contain:

- A description of the requested change, especially as it differs from the original construction contract;
- An itemized list of any costs;
- A statement of the contractual basis for the requested change; and
- Any impact on the current completion date of the project.

Common Problems Regarding Change Orders

Change orders are often rushed. Sometimes a subcontractor or supplier will receive a verbal request for a change prior to the written order because of time constraints to order materials. It could take weeks to get the written change order from the customer. Suppliers that act on changes to an original contract without documentation could open themselves up to a dispute, including non- or delayed payment.

Before ordering additional products or providing additional labor, get your customer to issue or approve a supplemental customer purchase order number. Many jobs are priced as complete and do not anticipate changes or additions to the contract. Customers often do not want to approve unexpected—but required—additions that create change orders for additional billings. In addition, if an unconditional or final waiver of a lien has been executed on a scope of work and a change order has been received related to the original scope of work, it is advised and advantageous to ask for a new purchase order.

Subcontractors and suppliers want to satisfy their customers to the extent that they might be tempted to forgo a careful review of the amendments to the contract. However, when they do not take the time to ask questions, pushback or follow up on written change orders, they put themselves at risk for delayed payment or even nonpayment. Because change orders modify the original contract, they must review the change order to understand how it affects the original agreement and its impact to them.

Much like the original contract, a change order could contain unfavorable language for the seller. If they are not carefully reviewed, a material supplier might find itself at a disadvantage. Pay particular attention to the terms and conditions associated with the change order. It is not uncommon for the other party to add indemnification language into the change order or other terms and conditions that were not agreed to in the original contract. Change orders can often be a lightning rod for disputes such as when language references another contract or drawing.

To mitigate disputes that might arise later:

- Ask for confirmation when following up on changes.
- Document every step.
- Obtain legal guidance.

Proficient documentation procedures are critical for staying ahead when disputes arise—especially considering the various types of disputes. For example, if it pertains to over billing, provide documents such as the purchase order, invoice copies, proof of delivery, copies of any change orders and of course a billing summary that encompasses total purchase order values, including change orders, total billing and total payments.

If pricing is noted in the original contract, provide that to illustrate the value on invoices match the contract. As an example, if the dispute reflects the customer wants to hold back 5% retainage, what does the contract say about this? If there is no contract, what does the governing terms and conditions of the account state?

In particular, pay attention to the following:

- **Time is of the essence clauses.** These clauses can commit sellers to challenging deadlines that can lead to more disputes down the road. Timetables are negotiable so make sure you have enough time to honor the change order and keep yourself from being liable for damages.
- **Additional orders require a written change order clause.** If the contract specifies that changes or additional orders to the original contract be submitted as a change order, then the supplier should flag the customer account to reflect the written-change-order requirement. Otherwise, the seller may be at risk for delayed payments or worse, nonpayment for the additional goods and services provided by request.
- **Notice requirements.** If the change order includes a notice requirement with a deadline and you miss it, your company's rights may expire.

- **Freight issues.** If the completion schedule is tight and you need to use express shipping, ensure the written change order includes express freight. This is often disputed if the proper documentation is not provided.
- **Additional terms.** Language that ties your company to additional terms and conditions not previously agreed to in the original contract (e.g., referencing another contract).

Address Change Orders Before They Happen

Change order provisions sometimes are overlooked during the original contract negotiations. However, construction contracts should include a provision that specifies how change orders will be addressed.

The best way to prevent disputes starts with the initial negotiation period for the original contract. During these negotiations, subcontractors and suppliers must pay close attention to provisions outlining their scope of work and the change order process if their scope of work changes during project development and execution.

For example, the contract should require all change orders be written and signed by both parties, including the owner. Owners, as well as their lenders, tend to be the ones who pushback the most based on perceptions of uncontrolled cost overruns. So they often are the ones to hold up funds to general contractors and subcontractors over change orders. It also should acknowledge that the contractor is not required to proceed until agreement has been reached on scope, price and additional time.

Frequently issues develop during the contract period because one or multiple parties did not understand the contents of the signed agreement because they did not take the time to read the documents or they did not comprehend what they read. All parties directly involved in the contract should negotiate in language that clearly identifies their objectives and requirements. To improve the negotiation process, as the specific terms are negotiated, understand what terms are “must haves” vs those that are “nice to have.”

Language regarding any provision is subject to a rebuttal from the other party. Therefore, subs and suppliers should remain aware of strategies they can apply that will ease tensions and promote collaboration. Develop creative ideas on how to rewrite provisions so that they do what both parties need. If there are timelines involved, make sure all parties are aware.

If a change order or purchase order has notice requirements, include language for notification when a change in the scope of work is *reasonably known* because you might not know the exact date when the trigger event took place.

Provide customers with choices to further entice them with easier decisions during the negotiation process. For example, if a change order clause states that payment to you will be issued once they are paid by the general contractor (paid when paid terms), consider offering them a few options instead. This may include joint-check guarantee agreements or some type of discount. Once an agreement is reached on the change order provisions in the original contract, carefully review the language that has been implemented.

Include crucial language such as “a contract must have the change order signed by both parties.” If this is included in the originally signed contract, subs and suppliers can maintain leverage because when their scope of work changes, they can immediately present an enforceable change order to the general contractor.

With enforceable provisions in effect, subcontractors and suppliers may cease work if the general contractor refuses to sign the presented change order. Without this provision, however, material suppliers may be exposed to high risks by taking this route because they may be subject to claims of breach of contract.