

## Contractor vs. Owner: Negotiating Warranties in Commercial Construction

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In the commercial construction setting, warranties can be written to commence as of substantial completion, final completion, date of beneficial use, date of installation or some other agreed-upon triggering event. The commencement date of the warranty (let alone the duration) can greatly impact a contractor's financial and performance obligations for the instant project, as well as for future work. As an owner, the commencement date—and duration—of a warranty, and the types of warranties given, impact whether the owner will have the benefit of a contractor knowledgeable with the owner's project to make timely repairs at no additional cost to the owner, should any aspect of the project fail or prove to be deficient post-construction.

### Contractors

For a general contractor on a large project, whether its warranty commences upon substantial or final completion, in theory, the timing difference would be no more than perhaps 60 days—the projected period for completion of punch-list items, resolution of open change order requests, and delivery of project closeout documents. If, however, the time to close out a project is extended due to disputes with the project owner or otherwise, for the contractor whose warranty is to commence on final completion, this 60-day window could easily become a window of 90 days or longer. With the warranty period pushed out, the contractor can be negatively impacted in a variety of ways, including its ability to fulfill obligations on future projects, its bonding capacity and its bottom line.

For the subcontractor undertaking work in the earliest stage of a project, the impact of the commencement of the agreed warranty period can have far greater impact. If a subcontractor completes an access road for a project, other project contractors will then use that roadway to access the project site long before the project is opened to the public. If the subcontractor's warranty period only commences upon completion (substantial or final) of the entire project, its accepted work may have been subjected to substantial wear and tear long before the completion of the project. It is very likely that the roadway would prematurely age, requiring the subcontractor to, in effect, have a warranty period extending from the completion of *its* work, through final completion of the project (perhaps a year or two later), and then through one or two years following final completion.

If an owner loses funding, and a project is suspended while new financing is put into place, here, too, the wear and tear on work already performed will likely cause satisfactorily installed work to prematurely age, requiring warranty repairs that might not have even arisen in the warranty period, had the project been completed in accordance with its original schedule.

The contractor, in agreeing to a warranty period of any duration, must also be mindful of its future projects. Will the contractor need to pull forces from the next project to return to a completed project to undertake warranty work? If warranty work requires special equipment that has already been redeployed for new work, the new work could be delayed while resources are pulled to the prior location to fulfill warranty obligations. For a bonded job, if the project completion is delayed through no fault of the contractor, a delayed completion date will tie up the contractor's bonding capacity further—particularly if a warranty bond is required, too.

Contractors should be prepared to stand behind and warranty the quality of their workmanship and their materials. When negotiating warranty commencement dates and durations, however, contractors should give careful consideration to how their work relates to the project overall; whether it is completed (or partially completed) work will be impacted by other (subsequent) work and/or delays, and to plan and protect itself accordingly for the instant project as well as its future commitments.

## **Owners**

When an owner hires a contractor to construct a project, regardless of the type of construction and/or intended use, the owner expects to receive a quality product that the owner can use and occupy for many years to come. Subject to the statute of repose, the owner expects its contractor to correct nonconforming and otherwise deficient work; and the owner expects this work to be performed promptly and at no cost to the owner.

First, the owner should consider the commencement of the warranty: ideally, from the owner's perspective, the warranty would not commence before final completion has been achieved—including completion of all punch-list items. In response, the contractor may press for the warranty to commence on substantial completion. The owner should carefully define "substantial completion" to be clear what criteria must be met to achieve this important milestone. In theory, the only open issues as to substantial completion should be minor "finish" items reflected on a punch list. Nevertheless, the owner may want full protection to run from the date of final completion (with deficiencies in the work before that date being subject to the contractor's obligation to correct such work before any warranty period begins to run).

Next, the owner should consider the duration of the warranty—typically, contractors will press for no more than one year. However, depending upon the nature of the work, the complexity of the construction, the nature of the systems serving the project, etc., a two-year warranty (or longer) may be more appropriate.

Owners should also consider how and when a warranty will run if the project has multiple phases. If phase 1 is substantially complete on day 1, and phase 2 is not substantially complete until day 180, query whether there should be one warranty that commences on day 180 for both phases. Alternatively, an owner could press for two separate warranties: one for phase 1, commencing on day 1, and a second warranty for the project as a whole, commencing on final completion of all phases.

If warranty work is performed in the first year of a two-year warranty period, the owner may then want to mandate that the warranty for the repaired work begin anew for that work (with another full two-year warranty period). Often times, if contractors agree to this concept, the contractors will press for an outside date by which the warranty will expire, for both original work and any repaired work (e.g., in all cases, no more than three years from substantial (or final) completion).

The warranty should also be clear as to what is warranted and to what standard. Should work be in accordance with "accepted industry standard for similar projects in the area," or should the work be in accordance with best industry practices? Certainly, the owner wants to know that all materials for the project are new when installed (unless certain materials are to be recycled), the work should be executed and completed in accordance with the plans, and performed in a good, workmanlike manner.

If a warranty claim is asserted, the owner should know that all parts and labor will be covered under the warranty by the contractor. Further, if conforming work must be removed to access the deficient work, then the contractor should also bear the cost to remove and reinstall conforming work (or "in and out" costs).

The contractor should be required to respond to a warranty claim within an agreed time frame. Often times, contractors will have long since moved on to the next project. The owner with a warranty claim should have assurance that the contractor will return to the job site and affect the warranty repair within (e.g.) 10 days. Further, if the contractor fails to undertake warranty work, the owner should be able to self-perform (or retain separate contractors to perform) the work, and require the contractor to reimburse the owner for its costs. Of course the concern here is whether the owner will then have to pursue the original contractor for such reimbursement. Owners may want to include an attorney fee recovery clause in such cases.

An owner should consider whether "special" warranties are required or desired. Special warranties will relate to a particular aspect or system for a project (e.g., an elevator, escalator or HVAC system), and may merit a longer warranty period than a "standard" one- or two-year warranty. In asking for such warranties, owners should also be mindful as to what entity is standing behind the warranty: is the warranty from the contractor, or is the warranty from the manufacturer of the subject system.

If the warranty is from the manufacturer, then the owner should confirm:

- That the manufacturer is reputable. It is fine to have a five-year warranty, but if the manufacturer is out of business or untraceable after the project is complete, the warranty will be worth only the paper on which it is written.
- That the manufacturer has insurance. If the manufacturer becomes insolvent, is there a reputable carrier standing behind the warranty?
- That the warranty is assignable—assuming the contractor intends to assign the manufacturer's warranty to the owner.
- What does the warranty cover: parts only, or labor and shipping costs, too?

- Whether only manufacturer-certified contractors can maintain the warranted system, and what activities could void the warranty.
- How quickly will a warranty claim be addressed and resolved?

Finally, if the owner has any concerns regarding the contractor's financial stability and/or reliability as to the execution of warranty work, the owner should consider mandating financial support for this work, which may be in the form of a warranty bond, letter of credit or other assurance.

As with many issues in the negotiation and performance of and under a construction agreement, the interests of the contractor and the owner are competing and conflicting as to warranty undertakings. While the contractor wants to limit its warranty obligations, the owner will seek to maximize the contractor's warranty obligation, in each case as to duration, repair work (labor and parts) and timing of repairs. Ideally, construction work will be performed in the first instance in accordance with agreed upon plans and standards; but when work or components thereof fail, the terms of the warranty will define which party will bear the time and expense to redress the same.

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