

Contracts 101

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While previous articles in STRUCTURE have looked at specific contract provisions – for example, the Waiver of Consequential Damages in the November 2021 issue – this article discusses contracts in general.

Rights and Obligations

What is a contract? While the answer seems obvious, having a specific definition in mind is helpful when reviewing contracts. A good definition is: “A contract is a statement of the parties’ rights and obligations.” Rights and obligations are typically framed as promises and are often reciprocal. For example, the Owner’s obligation to pay the Engineer creates a reciprocal right for the Engineer to be paid.

In a professional services contract, there are two main promises – a service provider such as the Engineer promises to provide the services, and the Owner promises to pay for the services. There will be several other promises, however. These typically include promises concerning the quality of the services, the timing of the services, the timing of the payment, and the Engineer’s obligation to comply with applicable laws. The word *promise* is seldom if ever used, however. Instead, promises are generally stated with the word *shall* or *must*.

Rights can be implied. For example, saying “The Owner shall pay the Engineer within thirty (30) days of receiving an invoice” creates an implied right for the Engineer to be paid within thirty days. Rights can also be explicitly stated, for example: “The Owner shall have the right to audit records for Reimbursable Expenses and any services provided on a time and materials basis.”

Rights are also sometimes established using *will* or *may*. Although there is some disagreement about the meaning of these words, *will* and *may* are typically used to provide information or create a right without implying any obligation. For example, “The Owner may hire additional consultants for the Project.”

Contract Versus Agreement

Legally, a *contract* is the same as an *agreement*. They both refer to a statement of the parties’ rights and obligations. While contract might seem to imply something more definite than agreement, the words are interchangeable. In the A/E/C industry, there is a tendency to refer to agreements with design professionals and other consultants as *agreements*, and

agreements with the Contractor and other construction professionals as *contracts*, but the distinction is simply to help keep the various agreements on the project clear. A prime consultant’s agreements with its subconsultants are generally referred to as *subcontracts*, although they can also be referred to as *subconsultancy agreements*.

Defined Terms

A/E/C contracts typically make liberal use of *defined terms*. A defined term is simply a capitalized term that replaces a word or group of words. Sometimes contracts have a definitions section, but often terms are just defined the first time they are used by putting them in quotes and parentheses. For example, “This agreement (“Agreement”) is entered into effective the 12th of August, 2021 (the “Effective Date”) between Lakeshore Holdings, Inc. (“Owner”) and Grey Engineers, LLP (“Engineer”).” Any references in the agreement to the capitalized words *Agreement* or *Owner* or *Engineer* or *Effective Date* will mean these defined terms. Other terms that are commonly defined are the *Standard of Care* and the *Services*.

Recitals and Preambles

Contracts sometimes start with a preamble, recitals, or both. A *preamble* is a paragraph that typically identifies the parties and the project. *Recitals* are clauses that begin with “Whereas” and generally indicate the parties’ desire to enter into the contract. For example, “Whereas Owner desires to engage a design professional for the work of this contract.” Often the recitals or preamble will be followed by a statement such as “For good and valuable consideration the parties thus agree...” This is followed by the actual contract terms. There is some disagreement over whether the recitals and preamble are part of the contract, but generally recitals and preambles just provide information about the project without creating any rights or obligations. If a recital contains important information such as a reference to a letter of intent, the agreement may start with: “The recitals above are incorporated into this agreement as if they are specifically stated herein.” This makes it clear that the recitals are part of the contract. However, even without such a statement, it is generally understood that, by signing the agreement, the parties have agreed that the information in the recitals or preamble is correct.



Proposals versus Contracts

Often, an Owner or Prime Consultant will ask the Engineer for a *proposal* to provide certain services. The Engineer generally prepares a proposal and attaches its standard terms and conditions. If the Owner or Prime signs the proposal, it becomes the contract. However, the Owner or Prime may send the Engineer its standard contract form, which usually includes an *entire agreement* clause. While the wording of this clause can vary, it will typically say something like, “This Contract constitutes the entire agreement between the parties and supersedes and cancels all other prior agreements including, but not limited to, any proposals or oral agreements. Engineer’s proposal is attached for scope and fee only; all other terms are expressly rejected.” This means that provisions such as payment terms, limitation of liability, or waiver of consequential damages in the Engineer’s proposal will not be included in the contract unless they are explicitly stated. If the parties are signing anything other than the Engineer’s proposal, the Engineer should closely review the terms and conditions to ensure that the agreement includes appropriate risk management provisions.

Conclusion

Reviewing a lengthy Owner-drafted contract can be a daunting undertaking, and it helps to keep the above basic principles in mind. If there is something in a contract that you do not understand or does not seem to make sense, you should strike it out or ask for clarification. Often contracts are copied from other projects and have terms that are incorrect or not applicable. Having a knowledgeable A/E/C attorney review the contract with you can be an invaluable part of your risk management practices.

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