

Construction Contracts: An Illustration of the Different Legal Systems in the U.S. and the European Union



As described in our earlier articles, “Mind the Gap! Pitfalls and Risks to Consider When Moving Production to the U.S.” and “Navigating the Land of Opportunity: An Introduction to the Unique Legal System of the United States,” the U.S. common law system provides fewer statutory protections to parties in a contractual relationship compared to the EU. The absence of these statutory protections allows sophisticated parties substantial freedom to negotiate. Yet, the lack of automatic safeguards can lead to lengthy and costly disputes for the unwary, particularly within the U.S.’ litigious environment. Without the EU’s self-executing protections, contracting parties in the U.S. must be certain to include all necessary protections within the “four corners” of their contracts. Accordingly, when operating in the U.S., one must understand that the specific provisions of a contract – and only those provisions – will govern the parties’ rights, obligations, and legal exposure.

Statutory Protections in the EU

Unlike the U.S., the EU has adopted a variety of codified laws that apply to contracts, limiting the ability of the parties to negotiate specific terms but ensuring each party retains certain inherent protections. For example, Title 9 of the German Civil Code (BGB) governs contractual relationships between buyers and sellers. The code also regulates contractual relationships between architects, engineers, and customers; within these provisions, it provides warranties, termination rights, and the regulation of unit rates for a variety of services. Likewise, the HOAI (Honorarordnung für Architekten und Ingenieure), a German regulation, provides a fee scale for architects and engineers, setting minimum and maximum rates for specific services. Although the legality of certain aspects of the HOAI is currently contested under EU law, it nonetheless illustrates the protections afforded to EU contracts. These protections enable the parties to resolve their contract disputes expediently and inexpensively.

To maximize the benefits of the U.S. contractual system, understanding the broader business climate is inevitable. The U.S. business climate differs substantially from the EU due to the size and how U.S. projects are completed. For example, unit price contracts (Einheitspreisverträge) are quite popular in Germany. These contracts are based on various laws in which the client pays for a specified outcome or amount of a product. Although unit-price contracts are commonly used successfully throughout the EU, they create various pitfalls if used in the U.S. For instance, unlike the EU, many U.S. contractors do not pay their employees rates derived from long-term, union-negotiated wages. Rather, these employees are paid according to the local market environment. Accordingly, a U.S. contractor that accepts a unit price contract must incorporate market risks into its bid, thereby protecting itself from a fluid labor market that may lead to the scarcity of subcontractors or marked increases in pricing. A good example is the oil and gas industry. When gas prices are high, substantial investments are made throughout the industry within a short period, which drains the labor market with the effect that wages are going up.

U.S. Approach: Mitigate Risk via Contract Selection

In light of the above-mentioned market risks and the lack of abundant regulatory safeguards, three different contracting structures have evolved in the U.S. for you to consider:

1. Time and material (T&M)
2. Guaranteed maximum price (GMP)
3. Lump sum contracts

These structures are largely based on the distribution of the risks between the contractor and the owner and employ a distinct method to achieve the customer’s needs while preserving interest and competition among contractors. Figures 1 and 2 illustrate the differences in risk allocation between the parties within these three major contract styles.

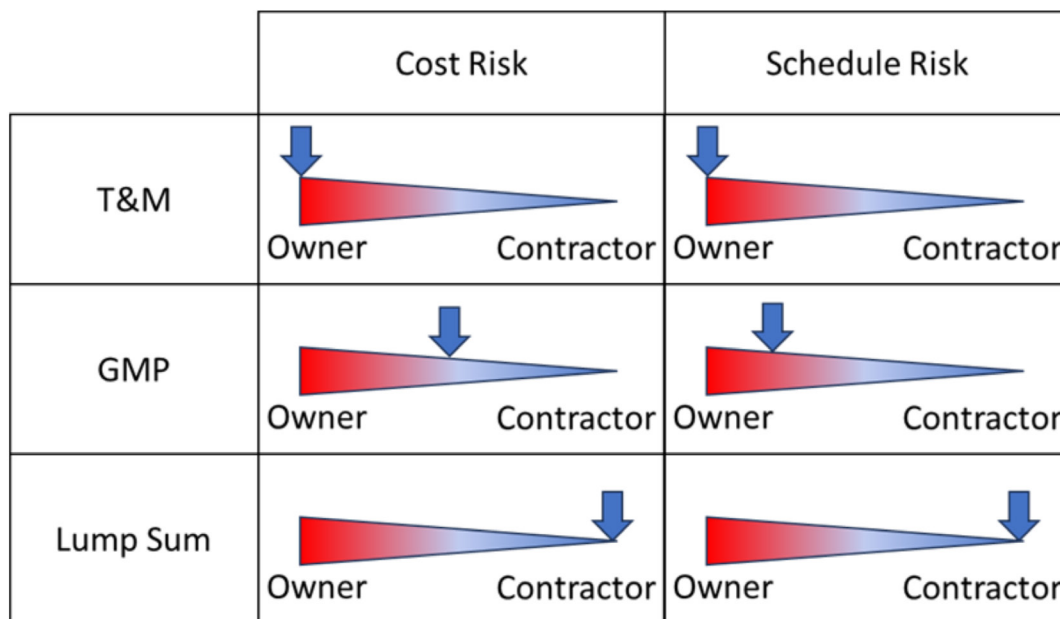


Figure 1: Risk distribution of commonly used contracting structures in the U.S.

Lump sum and GMP contracts require a well-defined scope of work. These contract styles are typically employed when the owner can specify the desired outcome. For example, a company may solicit bids for the construction of a climate-controlled warehouse. This type of contract defines a project according to the customer's desired functionality and specific needs. Contractors receive a precise description of the desired work, and the scope often includes the entire project. The lump-sum contract will specify the size of the warehouse as well as the specific type of air conditioning necessary to satisfy the customer's needs. Contractors understand the customer's functional requirements before their bid submittal. Once the contract has been awarded, the contractor is obligated to bring the project to fruition. Conversely, lump sum contracts are typically employed for engineering, procurement, and construction (EPC), construction managers at risk (CMAR), and design-build project delivery methods, as indicated in Figure 3 below.

T&M and cost-plus contracts are on the other end of the scale and are frequently used as a less desirable, albeit necessary, alternative from the owner's perspective. These contracts are generally employed when the scope is unknown or will be dynamic throughout the project scope. T&M bidders quote an hourly wage as well as the materials necessary to complete the project. In these scenarios, the contractor retains significant latitude with respect to the time spent and materials used in the project.

Identifying the most suitable contract structure ultimately depends on the work product and the project delivery methods that should be part of any project procurement strategy. Factors such as scope maturity, varying labor conditions, project complexity, and the anticipated extent of the owner's involvement should impact the corresponding risk assessment to identify the optimal project delivery method and contract structure.

Figure 3 provides an additional overview of project delivery methods in design and construction with the typically associated contracting structures used in the U.S.

Contract Style	Cost + Schedule Control	Risk Premium	Contractor Performance Risks	Quality Risks
Time and Material (T&M)	Full transparency of the incurred cost of the contractor and the effort to control the cost, schedule, and quality is upon the owner.	The risk is full on the owner's side. There is no risk premium for the contractor.	The contractor has no incentives to be efficient.	The contractor has no cost pressure. The quality assurance work product may be readjusted.
Guaranteed Maximum Price (GMP)	The contractor agrees to complete the project within a defined maximum price in a GMP contract. However, unlike a lump sum contract, the actual costs incurred by the contractor during construction are reimbursed to them up to the agreed-upon maximum.	<p>If the actual costs are less than the guaranteed maximum price, the savings may be shared between the owner and the contractor.</p> <p>On the other hand, if costs exceed the agreed maximum, the contractor typically bears the responsibility for covering the overruns.</p>	The contractor is incentivized to reduce expenses, given the contractual cap on the overall project cost.	The contractor tries to minimize construction spend by using lower-cost products, typically at the expense of quality and functionality.
Lump Sum	Fixed Price. The contractor is responsible for covering costs and managing any project delays.	This is the highest risk premium since the contractor must cover unforeseen circumstances and the timely delivery of the work product.	The contractor is incentivized to minimize the project duration to limit personnel costs. This is typically achieved by highly qualified workers and efficient work processes.	The contractor tries to minimize construction costs by using lower-cost products, typically at the expense of quality and functionality.

Figure 2: The three most used contract styles in the U.S.

Project Delivery Method	Use	Frequently Used Contracting Structures Within the U.S.
Design-Bid-Design (DBB)	<p>Most used when the scope is evolving during the design and construction phase. The owner needs to hold several contracts, such as:</p> <ul style="list-style-type: none"> • Design • Engineering • Construction 	<p>GMP T&M</p>
Design-Build (DB)	<p>This may be referenced to as a "fast-track" process. The contractor is responsible for the architect, and the design and construction processes occur simultaneously. This method is typically used for simple construction projects with limited design features, such as warehouses and offices.</p>	<p>Cost-plus GMP</p>
Engineering, Procurement, and Construction (EPC)	<p>Typically used for complex and large projects. (e.g., infrastructure, utilities, chemicals, oil, and gas). The owner handles just one contract for engineering and construction.</p>	<p>GMP Cost-plus/T&M</p>
Construction Management at Risk (CMAR)	<p>A general contractor is selected as a construction manager to provide input during the design phase, typically based on T&M, and will later provide a firm price for the construction once the design is completed.</p>	<p>Lump sum or GMP during execution</p>

Figure 5: General overview of project delivery methods and associated contracting styles commonly used in the U.S.

Although project delivery methods and contract styles are also known in Europe, companies typically need third-party support to assess the best strategies by acknowledging the lack of protections and different market conditions in the U.S.

At [Chambliss and MxV Consulting Group](#), we are a team of legal and technical advisors who have significant experience and knowledge of construction contracting strategies and contract structures that best suit your needs in your projects. If you have questions or need help bridging the gaps between U.S. and European standards, please contact [Brian Eftink](#), [Jeffrey Maddux](#), or [Helge Nestler](#) for guidance.

This constitutes Advertising Material. No representation is made that the quality of the legal services to be performed is greater than the quality of legal services performed by other lawyers. This material is informational, does not provide legal advice, and does not create an attorney-client relationship.
© 2024 Chambliss, Bahner & Stophel, P.C. All Rights Reserved.