

# Key Considerations for Restaurant Construction Contracts

By Kirk J. McCormick on June 28, 2022



Restaurant owners are well aware of the financial risks associated with running a restaurant, especially after over two years of pandemic-driven impacts across the restaurant industry. Just as important, however, is an awareness of the financial risks associated with building the restaurant space in the first place. Although no contract can completely shield an owner from such risks, below are some tips for drafting and negotiating your construction contract to minimize these risks.

## 1. Avoid cost-plus contracts.

Cost-plus contracts should be avoided for two reasons. First, they involve a significant administrative component, as the owner and/or the architect must review the invoices and audit the contractor's books to ensure that the claimed costs are reimbursable under the terms of the contract. Second, and more importantly, these contracts provide no incentive to contractors to control costs, unlike a fixed-price contract in which the price is set and the contractor bears the risk of completing the project within that price. If at all possible, choose a fixed-price contract. Alternatively, if the project involves more risk to the contractor (due to unknown conditions or an unfinished design) and you must enter into a cost-plus contract, establish a guaranteed maximum price (GMP) to cap the costs.

## 2. Avoid upfront deposits.

The key to successfully managing a construction project is controlling the flow of money, and an owner should avoid advance payments unless absolutely necessary. If there are certain specialty items or other items that a contractor needs to order and pay for in advance of the work beginning, a deposit may make sense. In most situations, however, payment of deposits should be avoided.

## 3. Define the scope of work!

Once the payment terms have been agreed upon, the owner expects the contractor to deliver a completed project in accordance with those terms. What happens, however, when the contract documents are unclear as to who is responsible for various aspects of making the completed project a reality? In a restaurant, for example, are the lights and fixtures to be provided by the owner? Who is responsible for securing permits? How much of the existing space is to be demolished and rebuilt? These are just a few of the questions that can come up if the scope is not sufficiently defined in the contract documents. Avoid the often-contentious disputes that can arise in this situation by clearly enumerating the exact scope of the contractor's responsibilities before the contract is signed.

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#### **4. Beware the assumptions and exclusions!**

This is a corollary to point number 3. Contractors may attempt to limit the scope of their responsibilities by including in the contract document a rider or separate set of exclusions and assumptions. The owner and architect must review these assumptions and exclusions very carefully to ensure that they are consistent with the exact scope of work that the owner intends the contractor to build.

#### **5. Provide for the withholding of retainage.**

Owners should include provisions in their contracts allowing them to withhold “retainage” from the contractor’s payments. “Retainage” is simply a withholding of a certain percentage (in Massachusetts, it is capped at 5% on projects over \$3 million) of each payment to the contractor. Similar to avoiding deposits, withholding retainage minimizes some of the risk that the contractor will fail to perform. For example, retainage provides the owner with leverage to ensure that defective work is replaced timely, and it also incentivizes the contractor to complete its work in a timely fashion.

#### **6. Provide a clear process for handling changes to the work.**

Changes are an inevitable part of all but the simplest of construction projects. Owners should recognize this fact and provide a clear contractual mechanism for addressing it. For example, owners should expressly provide for the process by which changes will be implemented and priced (such as by specifying the exact amount of any allowable contractor markup on changed work). Owners should also require that any changes be in writing and signed by the owner or the architect (to avoid disputes concerning alleged verbal changes to the work).

#### **7. Consider including a liquidated damages clause.**

Owners need to know that their restaurant will open on time. If it doesn’t, the owner will lose money – potentially a lot of money – and sometimes the amount of those damages is hard to establish with any certainty. Enter the liquidated damages clause. Such a clause allows the parties to stipulate in advance (to “liquidate”) the damages that will be assessed in the event the contractor does not complete the work by the contract deadline. These clauses require the contractor to pay the owner a set amount of money for every day that the project is delayed beyond the contractual completion date. In Massachusetts, these clauses are enforceable if the actual damages were difficult to ascertain at the time of contract and the liquidated damages are a reasonable forecast of the actual damages.

#### **8. Consider a no-damages-for-delay clause on larger projects.**

These clauses prevent the contractor from recovering delay damages in the event the project is delayed beyond its control. Instead, the contractor is limited an extension of time for performing the work. Because a contractor’s delay damages on larger projects can be significant, an owner should try to preclude the contractor’s recovery of such damages in the contract. In Massachusetts, no-damages-for-delay clauses are generally enforceable as long as the owner does not act arbitrarily or refuse to grant legitimate time extension requests.

#### **9. Require the contractor to remove or bond off liens.**

A mechanic’s lien is a method for securing payment for certain parties involved in construction, including the general contractor, subcontractors and suppliers (including subcontractors and suppliers that the owner is completely unaware of!). Essentially, a

perfected mechanic's lien – one that complies with all statutory requirements for enforcement – acts as a statutory mortgage on the property and provides the claimant with significant leverage. If the restaurant owner is leasing the space, the lien may apply to the leasehold interest, and it may even apply to the fee interest of the owner of the underlying property in the right circumstances.

To avoid this situation, the contract should require the general contractor to bond off or remove any liens at its expense. The contract should also require the contractor to indemnify the owner for any losses (including attorney's fees) incurred as a result of liens.

**10. Provide for a clear mechanism for terminating a nonperforming contractor for default.**

Unfortunately, sometimes contractors fail to perform. In that case, it is important to have a clear contract provision giving the owner the right to terminate the contract and replace the contractor. Without such a provision, a non-performing contractor could potentially contest the owner's attempts to replace it and further complicate what by then is already a difficult situation.

These are just a few of the issues restaurant owners should be aware of when drafting and negotiating their construction contracts. For additional assistance, please contact any of the attorneys in RIW's Construction Practice Group.

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