



Understanding and Managing Contingency in Guaranteed Maximum Price (GMP) Agreements in Construction Projects

Define Contingency Roles Early

Clearly distinguish between owner and contractor contingencies in the contract to avoid confusion and reduce disputes during the project.

Plan for the Unexpected

Set contingency amounts based on project complexity, design clarity, and risk allocation to ensure realistic budgeting from the start.

Control and Track Usage

Establish who can access contingency funds, how approvals work, and require detailed documentation to maintain transparency and accountability.

Balance Flexibility and Oversight

Allow enough control for timely decisions while preventing misuse—rigid or vague rules can both lead to delays or legal issues.

Use Contingency Strategically

Treat contingency as a risk management tool, not a slush fund—align incentives, monitor use, and reward efficient management.

Understanding and Managing Contingency in Guaranteed Maximum Price (GMP) Agreements in Construction Projects

BY GREG GILBERT

Introduction

In the world of construction contracts, particularly in large-scale and complex projects, managing cost uncertainty is a critical challenge. Guaranteed Maximum Price (GMP) agreements have emerged as a popular contractual framework to address this challenge, offering a structured approach to managing costs while providing a ceiling price to the project owner.

One of the key components of a GMP agreement is the inclusion of a Contingency, a reserved sum within the contract amount that acts as a financial cushion to accommodate unforeseen changes or risks that may arise during construction. This Contingency is vital for mitigating financial risks and ensuring the project remains within the agreed-upon maximum price, even when unexpected issues occur.

The use of Contingency in GMP agreements, however, is not without its complexities. While it serves as a safeguard against financial instability, it also introduces potential conflicts regarding ownership, control, and appropriate use of funds. Mismanagement of Contingency can lead to disputes between project stakeholders, undermining the benefits of the GMP structure.

This article explores the mechanics of Contingency in GMP agreements, detailing how it is established, managed, and adjusted. It also examines the pros and cons of including Contingency in these contracts, drawing insights from real-world cases and legal principles. By understanding both the practical and legal aspects of Contingency in GMP agreements, construction professionals and legal practitioners can make informed decisions when drafting and negotiating these contracts.

Mechanics of Contingency in GMP Agreements

The Contingency within a GMP agreement functions as a financial buffer designed to address unforeseen costs that may arise during the course of a complex construction project. Properly structuring and managing this Contingency is critical to maintaining budgetary control while allowing for flexibility in project execution.

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DEFINITION OF CONTINGENCY IN GMP CONTRACTS

In the context of a GMP contract, Contingency refers to a reserved amount of money set aside within the total contract price to cover unexpected expenses or risks that materialize during the project. It is important to distinguish between two primary types of Contingency:

- **Owner Contingency:** This fund is controlled by the project owner and is generally used for scope changes or enhancements that the owner elects to undertake during the project. These costs are not typically related to construction risk but rather to owner-directed changes.
- **Contractor Contingency:** Managed by the contractor, this fund covers unforeseen issues encountered during construction, such as site conditions differing from initial surveys, minor design discrepancies, or necessary adjustments to materials and methods.

Contractor Contingency is meant to address risks that the contractor assumes under the GMP agreement.

By explicitly defining these categories and their uses in the contract, parties can reduce potential disputes and ensure proper fund allocation.

HOW CONTINGENCY IS ESTABLISHED

The process of establishing a Contingency amount in a GMP agreement requires careful consideration of multiple factors, including the complexity of the project, historical risk of similar projects, clarity of project scope, and the allocation of risk in the contract to each party. One of the primary factors is the complexity of the project. For instance, more intricate projects such as semiconductor fabrication facilities often require higher Contingency amounts. This is due to the increased risk of technical challenges and the potential for evolving design requirements that such complex projects present.

Another crucial factor to consider is historical data and risk assessment. Contractors and owners can analyze similar past projects to estimate a realistic Contingency percentage.

The clarity of the project scope and the level of design completion also play a significant role in determining the Contingency amount. Projects with incomplete or evolving design documents may require a higher Contingency. This is to accommodate potential design refinements that may occur during the construction process.

The allocation of risk in the contract also influences the Contingency level. If the contract shifts more risk to the contractor, the Contingency percentage may increase. This is because the contractor is assuming more of the potential risks that may arise during the project.

Thus, a higher Contingency is required to cover these risks.

Typically, the Contingency is established during the pre-construction phase as part of the GMP formulation. In addition to considering the foregoing factors, it is crucial for the contract to explicitly outline how the Contingency was calculated to avoid future disputes.

MANAGEMENT AND USE OF CONTINGENCY

Proper management of the Contingency funds throughout the project lifecycle is essential for maintaining budgetary control. Owners and contractors must consider the control and authorization over Contingency funds. The contract should clearly delineate who has the authority to access these funds. For instance, if the Contingency is controlled by the contractor, they may need to obtain approval from the project owner for certain expenditures, particularly those that have a significant impact on the project's scope.

Contracting parties must also manage the documentation and reporting of Contingency usage. It is critical to maintain accurate and timely records of how these funds are used. This documentation should include records of any unforeseen conditions that arise during the project, estimates of the costs associated with mitigating these conditions, and any approvals obtained for the use of such funds. Transparent reporting of this information not only helps to maintain trust between the project stakeholders, but it also provides a solid foundation for justifying the spending of the Contingency funds.

The approval processes for accessing the Contingency funds should be standardized to minimize potential delays and disputes. The contract could stipulate certain thresholds for approval, with some expenditures being automatically approved and others requiring formal authorization from the project owner.

By considering these key aspects, project owners and contractors can effectively manage Contingency funds, ensuring that they are used appropriately and efficiently.

ADJUSTMENTS AND REVISIONS

During the course of a project, unforeseen circumstances may necessitate adjustments to the Contingency amount. Various situations could trigger such modifications. For instance, major alterations to the project's scope can deplete the original Contingency. In such cases, it may be necessary to renegotiate the GMP or secure additional funds to cover these unforeseen changes. Another scenario that may call for Contingency adjustments is the progressive realization of risk. As the project progresses and certain anticipated risks do not materialize, the unused Contingency funds may be reallocated to address emerging risks. Alternatively, if the contract permits, these unused funds may be returned to the project owner. If the Contingency is fully utilized before the completion of the project, the contractor may find themselves needing to bear additional costs. Depending on the terms of the contract, the contractor may need to negotiate an increase in the GMP to cover these additional expenses.

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The dynamic nature of project execution often requires flexibility in managing the Contingency amount. Whether it's scope changes, the non-realization of anticipated risks, or the exhaustion of Contingency funds, project stakeholders must be prepared to make necessary adjustments to ensure the successful completion of the project.

A well drafted GMP agreement will include clauses specifying how Contingency adjustments are handled, including the documentation required and the process for negotiating changes.

Pros of Using Contingency in GMP Agreements

Including a Contingency in GMP agreements offers several advantages, particularly in the context of sophisticated construction projects where risks and uncertainties are inherent. Properly structured Contingency clauses can provide financial security, promote efficient project management, and reduce the likelihood of disputes.

RISK MITIGATION

1. Addressing Unforeseen Costs and Changes

Complex construction projects often encounter unexpected challenges, such as design discrepancies, site condition variations, or material availability issues. The Contingency acts as a financial safeguard to cover these unplanned expenses without exceeding the GMP. For example, discovering unanticipated subsurface conditions during excavation may require additional stabilization measures, funded by the contractor's Contingency.

2. Reducing Disputes Between Owners and Contractors

By setting clear parameters for how the Contingency can be utilized, the parties reduce the likelihood of disputes over who bears the cost of unforeseen changes. When the contractor has control over the Contingency, they are better positioned to address minor issues without constantly seeking the owner's approval, streamlining the problem-solving process.

3. Managing Scope Creep

Contingency funds, particularly owner-controlled ones, help manage scope changes initiated by the owner during the project. This proactive approach allows owners to make minor enhancements or adjustments without renegotiating the entire GMP, maintaining project momentum.

BUDGET STABILITY

1. Protecting the Project Budget Against Variances

One of the primary reasons for including a Contingency is to protect the project from budget overruns. By accounting for potential risks from the outset, the contract establishes a financial buffer that helps maintain the GMP despite unforeseen expenditures. This stability is crucial for both public and private sector projects, where budget predictability is paramount.

2. Encouraging Realistic Budgeting

In the planning phase, the process of estimating a Contingency encourages contractors to conduct thorough risk assessments. This proactive risk management approach results in more accurate budgeting and reduces the likelihood of underestimating costs. By fostering a realistic understanding of potential challenges, the project team can develop a more comprehensive cost strategy.

3. Maintaining Stakeholder Confidence

Knowing that a project includes a Contingency can enhance stakeholder confidence, particularly when communicating with financiers or public agencies. Demonstrating that the project budget has been thoughtfully prepared with allowances for risks makes it more attractive for funding and public support.

IMPROVED PROJECT EFFICIENCY

1. Faster Decision-Making in Resolving Unforeseen Issues

When properly managed, Contingency funds allow project managers to address unexpected problems without halting construction to seek additional funding. This flexibility is especially valuable in fast-track projects where delays can significantly impact schedules and costs. For instance, if a specified material becomes unavailable, the contractor can promptly procure a substitute using the Contingency, avoiding costly delays.

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2. Enhanced Contractor Flexibility

Giving contractors controlled access to Contingency funds empowers them to make prompt, site-level decisions, fostering a proactive approach to problem-solving. This autonomy helps maintain construction momentum and reduces the administrative burden on the owner.

3. Flexibility in Addressing Minor Scope Changes

In some cases, minor adjustments to the project scope may be necessary to accommodate evolving requirements or unforeseen conditions. Instead of requiring formal change orders, the contractor can use the Contingency to fund minor modifications, thereby maintaining workflow continuity.

PROMOTING COLLABORATION AND ACCOUNTABILITY

1. Shared Responsibility for Risk Management

When both the owner and contractor have designated Contingency funds, it fosters a balanced approach to risk sharing. Each party understands their financial responsibilities, promoting a collaborative attitude toward resolving issues rather than assigning blame.

2. Incentivizing Efficient Contingency Use

Contracts can be structured to incentivize contractors to manage the Contingency prudently. For example, any unused portion of the contractor's Contingency at project completion may revert to the owner or be shared as a cost-saving bonus. This structure motivates contractors to minimize unnecessary expenditures.

3. Encouraging Transparent Communication

Clearly defining how Contingency funds are managed and reported promotes transparency between stakeholders. Regular updates on Contingency usage reduce suspicions of mismanagement and build trust among the project team.

Cons of Using Contingency in GMP Agreements

While Contingency funds in GMP agreements offer significant advantages, they also present potential drawbacks. If not properly defined, managed, and controlled, Contingency can become a source of financial inefficiency, disputes, and legal challenges.

POTENTIAL FOR MISUSE

1. Lack of Clarity in Defining Eligible Costs

One of the most significant risks associated with Contingency funds is the lack of precise definitions regarding their intended use. If the contract does not clearly distinguish between costs covered by Contingency and those that should be absorbed as part of the contractor's risk, disagreements are inevitable.

For instance, a contractor might use Contingency to cover costs arising from substandard workmanship or planning errors, which ideally should be borne by the contractor. Inadequate contractual language can lead to misuse, where Contingency becomes a catch-all for any unbudgeted expenses.

2. Risk of Using Contingency for Poor Planning

A poorly managed Contingency may incentivize lax planning or risk assessment during the pre-construction phase. If the contractor perceives Contingency as an accessible cushion, they may not devote sufficient effort to identifying potential issues during budgeting and design. This can result in higher-than-necessary Contingency amounts, inflating the GMP and reducing cost discipline.

3. Overuse Leading to Budget Overruns

If the contractor has unfettered control over the Contingency, there is a risk of excessive spending on minor or avoidable issues, rapidly depleting the fund. Without stringent approval and documentation processes, contractors might exhaust Contingency on non-critical tasks, leaving no reserves for significant unexpected events later in the project.

DISPUTES OVER CONTROL

1. Owner versus Contractor Control

A frequent point of contention in GMP agreements is who has the authority to access and allocate Contingency funds. Owners may feel that contractors misuse Contingency for costs that should be part of the base contract, while contractors may feel constrained by owners who refuse reasonable access.

For example, in projects where contractors control the Contingency, owners might demand detailed justifications for every expenditure, leading to conflicts and delays. Conversely, when owners control the Contingency, contractors may face challenges in promptly addressing site issues, slowing progress and increasing indirect costs.

2. Accountability Issues

If the contract does not specify who is responsible for monitoring Contingency usage, accountability can become blurred. Disputes may arise when the project faces a significant cost overrun, and the owner questions whether the Contingency was used prudently. Lack of oversight can also lead to contractors charging both Contingency and base costs for the same issues, effectively double-dipping.

3. Transparency Challenges

In some cases, contractors might not be transparent about how Contingency funds are utilized, especially if they perceive that full disclosure might lead to reductions in future Contingency allocations. This lack of transparency can erode trust and lead to disputes over cost reporting and financial management.

COMPLEXITY IN CONTRACT DRAFTING

1. Difficulty in Clearly Defining Usage

Drafting clear and enforceable Contingency clauses is inherently challenging. Legal practitioners must anticipate a wide range of potential issues and craft language that unequivocally delineates eligible expenses. Ambiguous clauses can lead to varied interpretations, increasing the risk of litigation.

For instance, terms like “unforeseen conditions” or “minor scope changes” can be interpreted differently by owners and contractors, depending on their perspectives and interests. Without precise language, even small ambiguities can lead to significant legal conflicts.

2. Increased Administrative Burden

Managing Contingency often requires meticulous record-keeping and constant communication between the contractor and owner. Tracking expenditures, obtaining approvals, and justifying the use of funds can consume valuable time and resources, potentially detracting from actual construction efforts.

3. Legal Risk from Inflexible Clauses

If the contract rigidly defines Contingency without allowing for reasonable adjustments, it may fail to accommodate the dynamic nature of complex projects. Inflexible Contingency provisions can hinder effective problem-solving, forcing contractors to navigate bureaucratic approval processes instead of addressing urgent issues on-site.

RISK OF INFLATING PROJECT COSTS

1. Excessive Contingency Leading to Overpricing

To minimize risk, contractors may propose inflated Contingency amounts during the bidding process. If owners lack sufficient knowledge to challenge these figures, the GMP can become disproportionately high. This inflated budget can reduce the project’s cost-effectiveness, particularly when much of the Contingency remains unused at project completion.

2. Discouraging Cost Efficiency

Knowing that Contingency funds are available may reduce the incentive for contractors to find cost-saving solutions. Instead of optimizing resources or streamlining operations, contractors may opt for easier but more expensive methods, assuming the Contingency will cover the difference.

3. Unused Contingency Funds and Reversion

If the contract specifies that unused Contingency reverts entirely to the owner, contractors may rush to spend the remaining amount near project completion to avoid losing access. This “use-it-or-lose-it” mentality can result in unnecessary or low-priority expenditures.

POTENTIAL FOR LEGAL DISPUTES

1. Vague Terms and Conditions

Poorly drafted Contingency provisions can give rise to disputes regarding whether certain costs are eligible for reimbursement. Without a clear and comprehensive list of acceptable uses, disagreements are likely to arise, potentially leading to arbitration or litigation.

2. Conflicting Interpretations

Even with well-drafted clauses, differing interpretations by contractors and owners can lead to conflicts. For example, while the contractor may view a particular site issue as unforeseen and thus covered by Contingency, the owner might argue that it was reasonably predictable and part of the contractor's assumed risk.

3. Post-Project Audits

Owners may conduct audits after project completion to verify how Contingency funds were used. If discrepancies are found, they may seek reimbursement, leading to legal action. Such disputes can tarnish professional relationships and result in prolonged legal battles.

Case Studies and Real-World Examples

To illustrate the practical implications of using Contingency in GMP agreements, it is helpful to examine real-world examples and case studies from complex construction projects. These cases highlight both the successful use of Contingency and the challenges that arise when it is mismanaged or poorly defined.

CASE STUDY 1:

Successful Use of Contingency in a Semiconductor Fabrication Facility

Project Overview:

A leading semiconductor manufacturer embarked on constructing a state-of-the-art fabrication facility in the U.S., valued at over \$5 billion. The project involved cutting-edge technology installations and strict compliance with environmental and safety regulations.

GMP Structure:

The contract incorporated a 10% Contingency, divided into 5% for the owner-controlled Contingency and 5% for the contractor-controlled Contingency. The owner's portion addressed scope changes, while the contractor's portion covered unforeseen construction risks.

Owners may conduct audits after project completion to verify how Contingency funds were used.

Challenges Encountered:

During the project, unexpected challenges arose, including:

- **Subsurface Conditions:** The site's soil composition differed significantly from preliminary surveys, requiring deeper foundational work.
- **Design Modifications:** Late-stage technological upgrades required adjustments to the HVAC and cleanroom systems.
- **Material Shortages:** Supply chain disruptions affected the availability of specified piping materials.

Contingency Utilization:

The contractor efficiently used their Contingency to address the foundational work and procure alternative materials without project delays. Meanwhile, the owner-controlled Contingency funded the HVAC upgrades, which aligned with evolving technological standards.

Outcome:

Clear contractual definitions and collaborative decision-making enabled smooth Contingency management. The project was completed within the GMP, and stakeholders acknowledged the effective use of Contingency as a critical factor in managing risks without compromising the schedule.

CASE STUDY 2:**Contingency Mismanagement in a Public Infrastructure Project****Project Overview:**

A state transportation department undertook a highway expansion project under a GMP contract valued at \$800 million. The contract included a 12% Contingency to address geological risks and design uncertainties.

Issues Arising:

The contractor had unilateral control over the Contingency, which led to several issues:

- **Premature Expenditure:** The contractor used Contingency funds early in the project to address minor, non-critical issues.
- **Lack of Justification:** Many Contingency uses lacked proper documentation, leading to questions about eligibility.
- **Exhaustion of Funds:** By the final project stages, the Contingency was depleted, but significant unforeseen issues remained, such as rockfall mitigation and unexpected groundwater intrusion.

Dispute and Litigation:

Upon audit, the transportation department discovered that approximately 30% of the Contingency had been used to correct planning errors and rework, which were not deemed legitimate Contingency expenditures.

A legal dispute ensued, with the state arguing that the contractor had misappropriated funds. The court ultimately ruled that vague contract language contributed to the misinterpretation, emphasizing the need for explicit Contingency guidelines.

Lessons Learned:

This case underscores the importance of precise contractual language regarding Contingency usage and the need for joint owner-contractor oversight to prevent premature or inappropriate spending.

CASE STUDY 3:**Dispute Over Owner-Controlled Contingency in a Hospital Construction Project****Project Overview:**

A major hospital construction project, valued at \$1.2 billion, was structured with a GMP contract including a 10% owner-controlled Contingency. The hospital's board insisted on retaining complete control to ensure financial prudence.

Problem Encountered:

The contractor encountered significant unforeseen challenges related to integrating complex medical infrastructure. Despite clear documentation of the issues and proposed solutions, the owner repeatedly delayed approving the use of Contingency funds.

Impact:

The project experienced considerable delays, increasing indirect costs and straining contractor-owner relations. The owner's reluctance to release Contingency funds, driven by concerns over cost overruns, resulted in inefficiencies and prolonged negotiations.

Resolution:

Following mediation, the parties agreed to establish a faster approval process for accessing Contingency. The revised approach balanced the owner's desire for control with the contractor's need for timely decisions, allowing the project to resume efficiently.

Takeaway:

This case highlights the risk of excessive owner control over Contingency, which can hinder prompt problem resolution. Establishing balanced control mechanisms can prevent delays while maintaining accountability.

Best Practices for Incorporating Contingency in GMP Agreements

To maximize the benefits and minimize the risks associated with Contingency in GMP agreements, it is essential to establish clear, balanced, and well-defined contractual provisions. Here are some best practices for effectively incorporating Contingency into GMP contracts, particularly for complex construction projects:

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CLEAR DEFINITIONS AND PROTOCOLS

1. Precisely Define Contingency Usage

One of the most critical aspects of drafting GMP agreements is clearly defining what constitutes an allowable use of Contingency funds. Use specific language to distinguish between costs covered by Contingency and

those deemed part of the base contract obligations. Consider categorizing Contingency as follows:

- **Construction Contingency:** To address unforeseen construction risks and challenges, such as site condition variances or material shortages.
- **Owner Contingency:** Reserved for scope changes, owner-directed modifications, or upgrades not anticipated during the initial project planning.
- **Design Contingency:** Used when project designs evolve during the construction phase, requiring adjustments or refinements.

By categorizing Contingency and clearly outlining the types of expenditures each category covers, parties reduce ambiguity and the risk of disputes.

2. Establish Rules for Access and Approval

The agreement should include a detailed protocol for accessing Contingency funds. This protocol should address several important considerations, including who has the authority to authorize use the Contingency funds, necessary justification documents, and appropriate approval thresholds. The project manager, owner, or a joint committee should be appointed as the approving entity for Contingency usage. The approving entity should be chosen depending on the project's structure and the parties' preferences.

The GMP agreement should also outline the documentation requirements necessary to justify the use of Contingency funds. This could include cost impact assessments, engineer reports, or change request forms, among other possible documents.

By clearly defining these requirements, parties can ensure that Contingency funds are used appropriately and that their use is well-documented. In addition, the GMP agreement should define approval thresholds for the use of Contingency funds. For instance, expenditures below a certain amount might be approved automatically by the contractor, while more significant uses require the owner's consent. By setting these thresholds, parties can balance the need for flexibility in managing unexpected costs with the need for oversight and control.

3. Specify Audit and Reporting Procedures

Regular reporting on Contingency usage is crucial for maintaining transparency and accountability. To facilitate this, it is important to incorporate specific clauses in the contract. A clause dedicated to periodic financial statements that details how much of the Contingency has been spent, what it has been spent on, and the remaining balance is integral to the proper tracking of the Contingency. Another clause should mandate the justification for expenditures. This includes providing descriptions of the unforeseen conditions or changes that necessitated the expenditure. The GMP contract should also grant post-project audit rights to the owner. This gives the owner the right to audit Contingency usage after the project's completion to ensure compliance with the contractual provisions.

ROBUST MONITORING AND REPORTING SYSTEMS

1. Implement Real-Time Tracking

Digital project management systems can be configured to track Contingency utilization in real time, providing dashboards that highlight approved expenditures, pending requests, and remaining balances.

Such systems facilitate proactive budget management and help detect potential misuse early.

2. Establish a Collaborative Review Process

To maintain a balance between control and efficiency, contracting parties should create a joint owner-contractor review panel that evaluates significant Contingency requests. This approach fosters transparency while allowing prompt decision-making.

3. Integrate Change Management Procedures

Since Contingency often intersects with change orders, integrate Contingency tracking with the project's broader change management framework. This integration helps streamline approvals and maintain consistency when handling unforeseen issues.

TRANSPARENT COMMUNICATION BETWEEN STAKEHOLDERS

1. Foster an Open Dialogue on Risk Management

During the pre-construction phase, stakeholders should openly discuss potential risks and how Contingency will address them. Collaborative risk workshops can identify potential issues and align expectations on how Contingency will be managed.

2. Regular Progress Meetings

Project stakeholders should schedule regular project meetings to review Contingency usage and address emerging challenges. These meetings should include financial updates to keep all parties informed of current expenditures and available funds.

3. Address Disputes Proactively

When disagreements arise regarding Contingency use, prompt and open discussions between the contractor and owner can help resolve them before they escalate into formal disputes. Including a dispute resolution clause specific to Contingency issues, should outline mediation and arbitration steps.

LEGAL SAFEGUARDS AND DISPUTE RESOLUTION CLAUSES

1. Draft Balanced Control Clauses

Contracting parties should avoid giving unilateral control of Contingency to either party. Instead, parties should allocate control based on the type of risk:

- Owner-Controlled for Scope Changes: Ensures that owner-initiated modifications do not overextend the contractor's budget.
- Contractor-Controlled for Construction Risks: Allows prompt action when technical or material issues arise.
- Joint Control for Gray Areas: For issues that may fall between the owner's directives and the contractor's responsibilities, joint approval mechanisms can be useful.

2. Include a Dispute Resolution Mechanism

Since disagreements over Contingency use are common, the contract should outline a clear process for resolving disputes. One option is to encourage mediation first, which promotes an amicable resolution before resorting to formal legal action. If mediation doesn't resolve the issue, the contract could provide for the appointment of a neutral expert to determine whether the use of Contingency was justified. As a last resort, particularly for high-value disputes that could significantly impact project finances, the contract could stipulate arbitration.

3. Stipulate Consequences for Misuse

Clearly outlining penalties for inappropriate use of Contingency, including the contractor's obligation to reimburse the owner or bear additional costs if the funds were improperly utilized, allows the owner to ensure proper use of the Contingency

INCENTIVES FOR EFFICIENT CONTINGENCY MANAGEMENT

1. Share Unused Contingency Savings

To encourage prudent use, the contracting parties should consider a clause that allows the contractor to share in the savings if the Contingency is not fully expended. This approach aligns the contractor's interests with cost efficiency and careful planning.

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2. Establish Performance Bonuses

If the contractor completes the project without exhausting the Contingency and without sacrificing quality or safety, the owner can offer a performance bonus. This incentive motivates the contractor to solve problems efficiently without defaulting to Contingency use.

3. Align Contingency Release with Milestones

The owner can also link the availability of portions of the Contingency to the completion of critical milestones. This method prevents premature use and ensures funds are preserved for later stages when risks might escalate.

TRAINING AND CAPACITY BUILDING

1. Educate Project Managers on Financial Controls

Ensuring that on-site managers understand the contractual stipulations surrounding Contingency will reduce the risk of improper use. Training should focus on cost tracking, justification processes, and compliance with approval protocols.

2. Legal Training for Contract Administration

Project administrators should be equipped with the legal knowledge to interpret Contingency clauses accurately and enforce compliance. Regular workshops and seminars can help keep project teams informed about best practices in Contingency management.

By incorporating these best practices, project owners and contractors can better manage Contingency funds within GMP agreements, reducing the potential for cost overruns and legal disputes. Clear protocols, transparent communication, and balanced control mechanisms are key to achieving successful outcomes in complex construction projects.

Conclusion

The inclusion of Contingency in GMP agreements is essential for managing the inherent uncertainties of complex construction projects. While Contingency serves as a critical financial buffer that helps maintain budget stability, it also requires careful planning, clear contractual definitions, and diligent management to maximize its benefits and minimize its risks.

BALANCING RISK AND FLEXIBILITY

GMP contracts are designed to provide a ceiling on project costs while allowing flexibility to address unforeseen conditions and design changes. The proper use of Contingency within these agreements embodies this balance by protecting both the owner and the contractor from unexpected financial burdens.

Achieving this balance, however, depends on well-drafted contractual provisions that clearly define Contingency types, eligible uses, and the authority to allocate funds.

COMMON PITFALLS AND LESSONS LEARNED

Real-world examples demonstrate that poorly defined Contingency clauses can lead to disputes, delays, and financial mismanagement. When either the owner or contractor has unilateral control over Contingency without clear guidelines, the result can be premature depletion or inappropriate use of funds. Conversely, overly rigid control by the owner can stifle the contractor's ability to address urgent issues promptly.

To avoid these pitfalls, contracts must specify not only how Contingency funds can be used but also how their use will be monitored and audited. Including a dispute resolution mechanism specifically related to Contingency management can further mitigate conflicts.

THE IMPORTANCE OF TRANSPARENT AND COLLABORATIVE PRACTICES

A recurring theme in successful GMP projects with Contingency is the establishment of a transparent, collaborative approach between owners and contractors. By holding regular meetings, sharing updates on Contingency usage, and fostering open communication, project stakeholders can align their financial management practices with the overall project goals.

Furthermore, incorporating digital tools for real-time tracking and reporting enhances accountability and helps prevent Contingency misuse. Establishing a culture of joint risk management, where both parties share responsibility for overcoming challenges, promotes more efficient and effective Contingency utilization.

LEGAL AND FINANCIAL SAFEGUARDS

From a legal perspective, drafting precise, unambiguous Contingency clauses is fundamental. Legal practitioners should focus on detailing the following:

- **Types of Contingency:** Clearly differentiate between owner-controlled and contractor-controlled funds.
- **Approval Processes:** Outline who has the authority to approve expenditures and under what circumstances.
- **Audit Rights:** Specify the owner's right to review Contingency usage during and after project completion.
- **Incentive Structures:** Include provisions that reward efficient use and discourage wasteful spending.

Incorporating these elements reduces the risk of contentious interpretations and promotes a fair and balanced approach to managing unforeseen costs.

STRATEGIC CONSIDERATIONS FOR FUTURE PROJECTS

As the construction industry continues to evolve, particularly in high-tech and infrastructure sectors, the role of Contingency within GMP

agreements will remain crucial. Future contracts should reflect lessons learned from past projects, emphasizing adaptive strategies that account for both technological advancements and shifting risk landscapes.

Integrating Contingency management into the broader project risk framework, rather than treating it as an isolated budget item, will enhance both predictability and resilience. Training project managers and legal teams on best practices in Contingency utilization will also help mitigate risks associated with cost overruns and contractual disputes.

FINAL THOUGHTS

Contingency in GMP agreements is not just a financial safety net; it is a strategic tool for navigating the complexities of modern construction projects. Embracing a structured, transparent, and balanced approach allows owners and contractors to better manage uncertainties, protect their financial interests, and deliver projects on time and within budget.

Indeed, effective Contingency management requires collaboration, clear contractual language, and a shared commitment to accountability. By implementing the best practices outlined in this article, stakeholders can optimize the use of Contingency, fostering successful project outcomes while minimizing the potential for disputes.



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