While both relatively simple concepts, allowances and contingencies are often confused with one another. Conflating the two can lead to pitfalls. An easy way to remind oneself of the difference is allowances are for known unknowns, and contingencies are for unknown unknowns.

**Allowances**

An allowance is an amount established in the contract documents for inclusion in the contract sum to cover the cost of prescribed items not specified in detail. Variations between such amounts and the finally determined cost of the prescribed items will be reflected in change orders appropriately adjusting the contract sum.

Contractors may want to keep the following points in mind when allocating and drafting allowances:

- Allowances are often used: (1) to permit flexibility in materials selection, such as the selection of finishes, lighting, or plumbing fixtures where the specifications have not been finalized; or (2) where a particular scope of work is anticipated but the extent of the work required is unknown at the time of contract formation.

- Allowances for materials usually cover only the cost of the materials and not the cost of labor to unload and install the materials or the cost of any design necessary for installation. The labor cost usually is already factored into the contract price.

- Allowances can be drafted to address the following:
  - Whether the allowances cover material only or both labor and material
  - What disclosure and authorization are required to exceed the allowance amounts
  - Whether overages and underages are reconciled through change orders or through the contingency

**Contingencies**

A contingency is an amount added to an estimate to allow for items, conditions, or events for which the state, occurrence, and/or effect are uncertain and that, in the contractor's experience, will likely result in additional costs. There are two general types of contingencies: (1) owner reserve (an amount set aside for additions to the project's scope or owner's risk items); and (2) contractor contingency (an amount built into the contractor's anticipated price for the project to account for various risk factors that cannot otherwise be accounted for in a schedule of values). A contractor contingency is used because there is a degree of statistical certainty that
unpredictable individual costs will arise; accordingly, the amount of the contingency is set at a level that balances the desire to have liquidity with the need to control risk. Contractors may want to keep the following points in mind when formulating contingencies:

- There are many risk factors for which to account, such as: incomplete designs; scope errors; construction disturbances (strikes, accidents, or breakdowns); bankruptcies; regulatory risk; estimating inaccuracy; technological change; calamitous weather; and unanticipated price or interest rate increases.

- Contingency disputes often arise on projects with cost-plus contracts with a guaranteed maximum price (CP/GMP). Because the contingency is within the GMP, the owner "funds" the contingency from which costs arising from the enumerated risks are drawn until the contingency fund is exhausted. Any unspent contingency funds at the end of the project typically revert to the owner or are shared. Disputes arise over entitlement to access the contingency, permitted uses, and misconceptions about the role of contingency.

- A good contingency clause does the following:
  - Clarifies whether the contingency is an owner's reserve or a contractor's contingency
  - Describes the types of costs (risks) for which the contingency is to be used
  - Sets out the process by which contingency is accessed during the project
  - Describes the paperwork and approvals needed to use contingency
  - Describes the supplemental funding of contingency and sharing of unspent contingency at project closeout.

The contractor's contingency exists to mitigate project-related risks for which the contractor is responsible. The contractor's contingency can be understood by all parties to be "spent" money. Disputes frequently arise when the parties lose sight of the basic purpose of the contractor's contingency and view the contingency as a possible source of project cost savings.

The attorneys in Ogletree Deakins' Construction Law Industry Group will continue to cover any developments, news, and legislation pertinent to the construction industry.