

“PROFESSIONAL LIABILITY OF THE CONSTRUCTION MANAGER”

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GOALS OF TODAY'S PRESENTATION

- Discuss The Two Principal Construction Management Roles
 - Construction Manager - Agent
 - Construction Manager – “At Risk”
- Identify the Most Significant Risks Associated with Those Roles
- Discuss Case Law Dealing with Liability of Construction Manager – Including Liability to Non-Contracting Parties

FOCUS OF TODAY'S PRESENTATION

- Identify Risks and Ways of Dealing with those Risks
- Audience Participation “Makes” the Presentation
- This Presentation does not deal with liabilities of a “Program Manager”, although there may be similarities.

THE ABSENCE OF STANDARDS RELATING TO CM'S PERFORMANCE

- CM's services typically treated as "professional services"
 - But many jurisdictions do not have specific CM licensing requirements
 - One state – Idaho – has a specific CM license
 - But some states may require some form of engineering, architect's or contractor's license to perform CM functions
 - District of Columbia: No specific requirement
 - Virginia Annotated Code Section 54.1-1100: Class A, B, C contractors "perform or manage construction . . ."
 - Maryland: Depends on the type of work the CM is performing

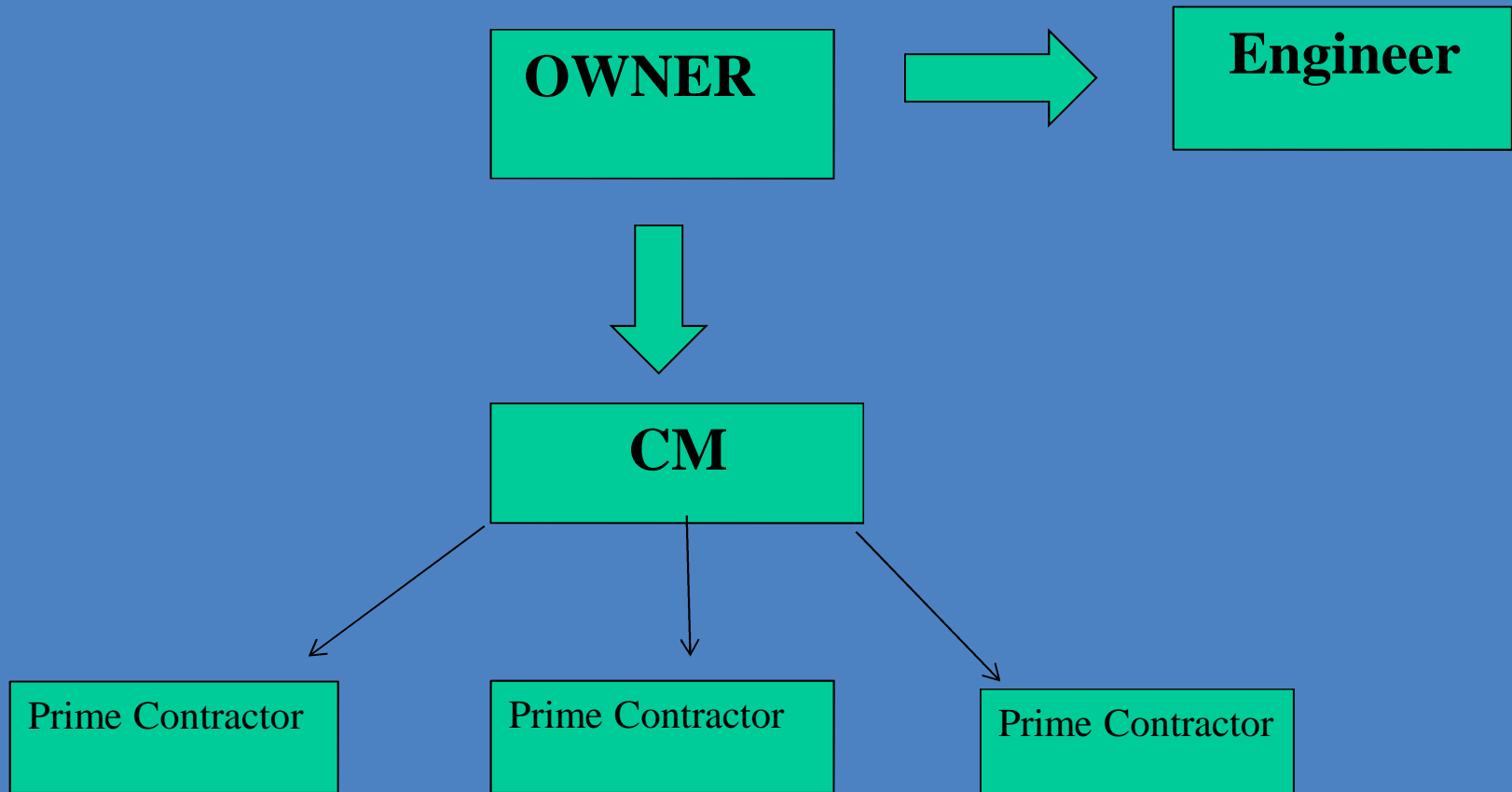
THE ABSENCE OF STANDARDS RELATING TO CM'S PERFORMANCE (cont.)

- Essentially no statutory guidance.
- There is very little case law – approximately 100 cases nationwide discuss the professional liabilities of construction managers.
- Because there are so many forms of Construction Managers, the duties of a CM are largely contract driven

Construction Manager “At Risk”

- Question: What is the difference between a Construction Manager “At Risk” and a General Contractor?

Structure of CM “At Risk” Project Delivery



CONSTRUCTION MANAGER - AT RISK

- CM contracts with the Owner to build the project
- CM is involved early and works with the architect/engineer in connection with the development of the design
- Participates (sometimes with critical subcontractors) in the design development
 - Answer to Question: This is the principal difference
- Develops budgets at critical design phases
- Assists with “value engineering” if design exceeds budget
- Prime contractors bid to CM (not to Owner)

Construction Manager – At Risk

- The “At Risk” Construction Manager holds all contracts for construction and is responsible for the management of the Project (except for the Architect) and all building tasks.
- The role assumes the same warranties as a GC and At Risk CM oversees the project “from permits to punch list”
- The contract may either be a lump sum or a guaranteed maximum price
- Responsible for CPM schedule (accepted by Owner)
- Essentially assumes all the risks of a GC, including job site safety
- Bottom Line: Bring job in **On Budget** and **On Time**

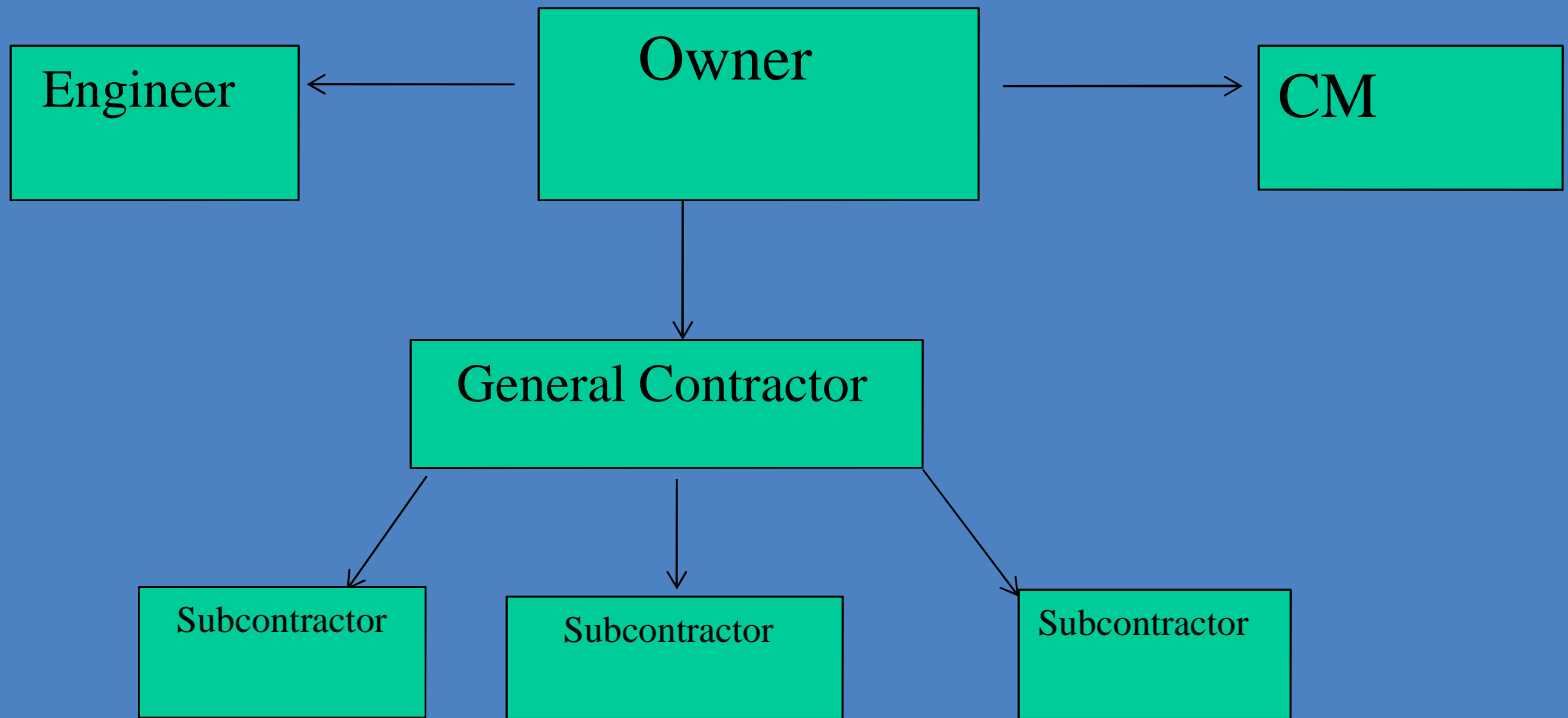
Construction Manager – At Risk

- “At Risk” CM
 - CM contracts with multiple prime contractors
 - At risk for the performance of its prime contractors
 - Coordination responsibility
 - Responsible for “scope gaps”
 - Responsible for “defective work” (QA/QC)
 - If a Prime Contractor does not perform, the CM has to determine how to proceed
 - Supplementation
 - Termination

Construction Manager - Agent

- CM - Agent
 - Contract is with owner and therefore principal risk is to the owner
 - Direct liability to owner for failure to perform contractual obligations
 - May be indirectly to the other project participants by virtue of indemnity obligations owed to the owner
 - Owner found to be liable – triggers CM's indemnity obligation

Structure of CM-Agent Project Delivery



Construction Manager - Agent

- The CM - Agent neither furnishes nor contracts for labor or materials for the construction but acts as the owner's representative or "agent" and assists the owner with:
 - Permitting
 - Estimating
 - Scheduling
 - Design/Constructability Reviews
 - Construction Bidding
 - Negotiating with Contractor
 - Overall construction management

Standard Construction Phase Obligations of CM/Agent

- Maintain Updated Project File
- Lead Project Meetings and
- Manage Submittal/RFI Process
- Draft Meeting Minutes
- Updated Schedule Review
- Monitor Progress of the Work (Daily Reports)
- Review/Approve Pay Applications
- Review/Approve Change Order Requests
- Coordination of Construction with Owner's Use of Project
- Monitor Project Safety

Contractual Liability of CM/Agent

- Duties depend upon specific requirements set forth in the Contract
- What if the Contract fails to spell out what constitutes “timely processing” of submittals, RFI’s, Change Order Requests, etc.?
- It is likely that either 1) a “reasonableness” standard will apply or 2) standards in the industry will apply to determine whether CM/Agent has satisfied its contractual duty.
- If a Project is “troubled”, CM’s performance will receive greater scrutiny.

Specific CM – Agent Risks

- Definition of work scope is critical
- Make sure that work scope is clearly defined between 1) Owner, 2) Architect, 3) Inspector, and 4) Construction Manager
 - Utilize “Matrix of Responsibilities
- Contracts should be coordinated and consistent
 - Avoid overlapping responsibilities
 - Participate in the contracting process with architect
 - Ambiguity is your enemy

Specific CM-Agent Risks

- Do not assume risks unless you have the ability to control them (e.g. safety)
- Failure to enforce the owner's rights = liability
 - Waiver of contractor's obligations
- Interference with or prevention of contractor's performance where CM fails to meet its contractual duties.

Contractual Liability of CM/Agent

- CM Agent Potential Liability
 - Failure to manage, organize and keep Project file current
 - Failure to keep complete and accurate Meeting Minutes
 - Failure to manage delays with submittal/RFI process
 - Failure to require Contractor to comply with Contract's schedule requirements
 - Failure to perform daily job walks (and to keep daily reports)
 - Untimely processing of pay applications; authorizing overpayments, etc.
 - “Verbal” change orders
 - Failure to timely process change orders (bundling of COR's)
 - Failure to provide timely access to Contractor
 - Failure to enforce jobsite safety requiremen

CM/Agent Liability

- What are the consequences of CM's breach?
 - Termination of CM Contract
 - Loss of remaining payments under contract
 - Cost to replace CM
 - Impacts ability to obtain future work
 - Potential liability for damages caused to 3rd parties
 - Owner sues CM indemnity for damages claimed by Contractor

Third Party Claims vs. CM Liability of Construction Manager - Agent

- **Question:** Can a third party sue the CM for Tort Liability? (It is typical to see CM's sued by contractors for negligence, negligent misrepresentation, or interference with contract.
- **Answer:** It depends upon whether the jurisdiction in which CM is working has adopted the "Economic Loss Doctrine."

Third Party Claims vs. CM-Agent

- Question: Can a general contractor prosecute a valid claim (lawsuit) directly against CM/Agent for failing to carry out its contractual duties?
- Answer: It depends upon where the Project is; or what jurisdiction's law applies.
- And whether the “Economic Loss” doctrine is applied in that jurisdiction.

WHAT IS THE ECONOMIC LOSS DOCTRINE?

- Contract Law vs. Tort Law Theories of Liability
 - Contract Law: Unless a “duty of care” exists between parties, a party can only sue another when the parties are in privity of contract (i.e. when they contract with each other.)
 - Tort Law: Where a duty of care exists between two parties, even in the absence of a contractual relationship, a party may sue another in tort.
 - So, the question is: Can an Architect, Contractor or Subcontractor sue a CM/Agent for the CM’s failure to carry out its obligations to the Owner?

THE ECONOMIC LOSS DOCTRINE

- **Definition:** Absent personal injury or property damage injury, where there is no privity of contract a defendant is not liable for the Plaintiff's economic losses.
 - This “rule” prevents a party from being exposed to limitless economic loss
 - It assumes that parties to an agreement will protect themselves through contract negotiations and if parties are subject to tort liability they will be liable to others for obligations they have not voluntarily assumed.

THE ECONOMIC LOSS DOCTRINE

- What does this mean?
 - A party suing for commercial loss is required to be in privity of contract with the party causing the loss – no contract means no recovery.
 - “Commercial loss” – not involving personal injury or property damage.

JURISDICTIONS WHERE THIRD PARTY LIABILITY IS ALIVE AND WELL

- At least fifteen states recognize tort claims by third parties against construction managers:
 - Alabama, Delaware, Florida, Hawaii, Indiana, Louisiana, Michigan, Minnesota, North Carolina, Pennsylvania, Rhode Island, South Carolina, Texas, Washington and Wyoming

JURISDICTIONS WHERE THIRD PARTY LIABILITY IS ALIVE AND WELL

- Presnell Const. Managers, Inc. v. EH Const., LLC, 134 S.W.3d 575 (Ky. 2004)
 - Court held that CM could be held liable to general contractor for negligent misrepresentation and but not for negligent supervision.

THIRD PARTY LIABILITY IS ALIVE AND WELL (cont.)

- **Danforth v. Acorn Structures, Inc.**, 608 A.2d 1194 (Del. 1992): Court refused to hold that economic loss doctrine applies to claims of professional negligence = CM could be liable.
- **John Martin Co. v. Morse / Diesel, Inc.**, 819 S.W.2d. 428 (Tenn. 1991): Court ruled that CM could be liable for contractors economic losses for negligent misrepresentation and negligently supervision of a project.
- **Strategem Development Corp. v. Heron Int'l**, 153 FRD 535 (S.D.N.Y. 1994): CM was allowed to sue architect for contribution / indemnity in a suit brought by owner, where CM claimed that architect caused project delay.

ECONOMIC LOSS DOCTRINE IN D.C

- Potomac Plaza Terraces v. QSC Products, 868 F. Supp. 346 (D. D.C. 1994)
- “While District of Columbia courts have ‘not decided whether economic loss is recoverable,’ see *Bowler v. Stewart-Warner Corp.*, 563 A.2d 344, 355 (D.C. 1989) (Ferren, J., concurring), a majority of other jurisdictions rejects claims for economic loss based on negligence, strict liability, or both. Most recently, Maryland joined those states that refuse to award damages for economic loss under both negligence and strict liability theories.”

ECONOMIC LOSS DOCTRINE IN VIRGINIA

- Gerald M. Moore & Son, Inc. v. Joseph Drewry; Drewry & Associates, 251 Va. 277, 467 S.E.2d 811 (1996)

- Facts: Project Owner sued employee of engineering firm for negligent performance of the contract
- Court held: Found that company had breached its contract.
- Court held: “However, even if the agent's (employee’s) negligence is established, absent privity of contract, Virginia's economic loss doctrine precludes the recovery of damages based on economic loss alone. ”

ECONOMIC LOSS DOCTRINE IN MARYLAND

- Morris v. Osrose Wood Preserving, 340 Md. 519, 529, 667 A.2d 624 (1995)
 - "The economic loss rule ordinarily prevents a plaintiff from pursuing a tort action to recover "purely economic losses - losses that involve neither a clear danger of physical injury or death, nor damage to property other than the product itself. . . The rule is supplanted only when the plaintiff passes the "legal threshold of pleading the existence of a clear and extreme danger of death or serious personal injury."

CM/Agent Pre-Construction Liability

- Constructability Review

- What does this mean?
- Some Definitions:
 - “The extent to which the design of the building facilitates ease of construction, subject to the overall requirements for the completed building.”
 - “A system for achieving optimum integration of construction knowledge and experience in planning, engineering, procurement and field operations in the building process, and balancing the various project and environmental constraints to achieve overall objectives.”
 - “A system for achieving optimum integration of construction knowledge in the building process and balancing the various project and environmental constraints to maximize achievement of project goals and building performance.”

CM/Agent Pre-Construction Liability

- The Problem: “Constructability” and the obligations that it imposes on a CM are not at all clear.
 - The CM is not responsible for the design; but what risks are transferred to the CM when it assumes the responsibility to perform a constructability review.
 - Is the CM responsible if it fails to find conflicts in the design?
 - What level of detail of review is required?
 - The payment to the CM for this scope of work frequently does not approach the value of the risk that the CM assumes.

CM/Agent Pre-Construction Liability

- Question: How do you deal with the potential risk associated with taking on a “Constructability” scope of work?
- Answers:
 - Insure the contract language is clear regarding the “extent” of the Constructability review.
 - Attempt to limit potential liability in the contract.
 - Damages liability capped at the amount paid for the Constructability review.

CM's Liability for Jobsite Safety

- **Question:** Can a CM be responsible for job site safety?
- **Answer:** The CM's Duty depends upon:
 - 1) It's contractual obligations, or
 - 2) If the CM retains control over the work and fails to exercise control with reasonable care (retained control).

CM's Liability for Jobsite Safety

- There are a number of layers of analysis that are required when confronting an issue of liability for jobsite safety. Federal OSHA, State OSHA, State statutory and case law.
- Recent Federal OSHA Cases (OSHA Safety Violations)
 - CH2M Hill: Engineer and Construction Manager
 - Three GC employees were killed by methane explosion

CM's Liability for Jobsite Safety

- The contract read:

“The general contractor and not the CM shall be responsible for all ‘means, methods, techniques, sequences, and procedures’ necessary for coordinating and completing all portions of the work performed under the construction contract and for safety precautions incidental thereto.”

CM's Liability for Jobsite Safety

- OSHA found CH2M Hill liable because of its broad range of planning, design and construction management obligations.
- CH2M Hill v. Herman, 192 F.3d 711 (7th Cir. 1999): Court reversed OSHA's ruling based upon 1) contract language, and 2) CH2M Hill did not exercise substantial supervision over actual construction.

CM's Liability for Jobsite Safety

Flemming Construction, Inc., 18 OSHC (BNA) 1708 (April 20, 1999)

- CM was required to coordinate the contractor's safety programs
- CM's authority was limited to monitoring and making recommendations to the owner or architect. CM did not have power to stop the work
- Labor Commission found CM not liable because it did not have enough authority to direct or control the actual performance of the construction work.

CM's Liability for Jobsite Safety

- Burkoski v. Structure Tone, Inc. 40 A.D. 3d 378, 836 NYS2d 130
 - Where a CM Agent assumes a duty to supervise and control the actions of contractors the CM assumes the duty to provide a safe work place.
 - Worker must prove that CM exercised direct supervisory control over the activity that caused the injury in order to prevail on a claim of failure to maintain a safe construction area)

CM Liability for Jobsite Safety

- Walls v. Turner Construction 4 N.Y.3d 861 (2005) Where CM had contractual duty to enforce compliance with applicable safety regulations and where the CM maintained authority to compel the contractor to correct unsafe work conditions, CM will be liable.
- Plan-Tec, Inc. v. Wiggins 443 N.E.2d 1212, (Ind. 1983): Where CM was appointed safety director, held site safety meetings, ordered safety precautions -- assumed duty for assuring safety of the worksite

Failure to Discover Defective Work

Christ Lutheran Church v. Equitable Church Builders, Inc. 909 SW 2d 451 (Tenn. 1995)

- Where CM agreed to furnish “periodic” job inspections and to act on behalf of the Owner to maintain “quality workmanship”, the CM was found to have a duty to supervise the quality of work during construction.
(Roof/wall collapse caused by defective work)
- But if duty is simply to report quality issues to the Owner, without a duty to discover defective work = no liability

Liability for Budget “Bust”

- Alibereti, LaRoche & Hodson Eng’g Corp. Inc. v. Federal Deposit Insurance Corp. 844 F. Supp. 832 844 (D. Maine, 1994):
 - CM failed to use reasonable care (was negligent) in reviewing the project documents to ensure inclusion of all line items in the budget and all components necessary for design within those line items.
 - This liability may extend to 3rd party lender who relied on CM’s budget estimate.
- Contracts may specifically exclude this liability (AIA and the EJCDC) disclaim this liability – budget estimates are not guaranteed or warranted.

Liability for Overpayment of Contractor

- Question: Can a CM be held liable for overpayments made to a contractor?

Liability for Overpayment to Contractor

- Answer:
 - First look to the CM contract
 - AIA form CM contract specifically disclaims liability for certification of progress payments
 - In absence of contractual disclaimer, liability may be found depending upon the facts at issue
 - Significant overpayment
 - Taking money from one account to pay contractor for changes that have not been approved.

CM At Risk's Liability for Scheduling

- Facts:
 - Construction of Orange County Florida Convention Center
 - CM At Risk's contract with prime contractor provided that CM had the right "to suspend, delay, or accelerate, in whole or in part, the commencement or execution of Trade Contractor's Work or any portion thereof or to vary the sequence thereof, to reasonably decide the time, order and priority of the various portions of Trade Contractor's Work, and all other matters relating to the Project."
 - Contract also provided that "Trade Contractor shall not be entitled to any additional compensation for decisions or changes made by [Construction Manager] pursuant to this Section 9.4 except as provided in Section 9.7"

CM At Risk's Scheduling Liability

- Facts (continued)
 - Shortly after the Prime Contractor signed its contract, the CM modified the schedule thereby accelerating the electrical contractors' work
 - Electrical contractor sued CM alleging it was entitled to acceleration and disruption costs
- Court held: The provisions of the contract giving the CM the discretion to modify the schedule had to be read in context of the CM's duty of good faith and fair dealing. The Court found that the CM's exercise of its discretion clearly exceeded that duty
- “Accordingly, the limitations of [the Rescheduling Clause] cannot shield [Construction Manager] from liability for its breach of its contractual obligations to schedule and coordinate the work on the Project.”

Construction Managers and Arbitration

Hughes Masonry v. Greater Clark County, 659 F.2d 836
(7th Cir. 1981)

- Facts
 - Masonry prime sued owner and owner moved to compel arbitration
 - Prime claimed that arbitration was precluded because of absence of "necessary party" (CM)
 - Prime sued CM in tort in separate lawsuit.
 - CM moved to compel arbitration under owner's contract

Construction Managers and Arbitration

- Hughes Masonry v. Greater Clark County, 659 F.2d 836 (7th Cir. 1981):
 - Owner/prime contract outlined CM's supervision responsibilities over prime contractors.
 - Prime's claims, although sounding in tort were grounded in CM's alleged breach of obligations in owner / prime contract
 - "Since contractor must rely on terms of owner/ prime agreement in its claims against CM, the contractor is estopped from repudiating arbitration agreement in its agreement."
 - Contractor could not separately sue CM outside of arbitration

Can CM Compel Party to Arbitrate?

- McBro Planning and Dev. v. Triangle Electrical, 741 F.2d 342 (11th Cir. 1984)
- Facts
 - Prime contractor claimed that CM harassed and hampered its work
 - Prime sued CM for intentional interference with contract and negligence
 - CM had no contract with prime but moved to compel arbitration under owner/prime contract
 - Prime Contractor argued "no privity – no contract – no right to arbitrate"

Can CM Compel a Party to Arbitrate?

- McBro Planning And Dev. v. Triangle Electrical
- Court's Holding:
 - Prime contractor relied on CM duties defined in owner's contract to sue CM
 - “The contractor's claims are intimately founded and intertwined with the underlying contractual obligations”
 - The Court compelled contractor's claims to be submitted to arbitration

Construction Manager's Insurance

- E & O insurance: Protects CM from claims based upon the performance of its professional duties
 - Prompt Notice Requirements
 - If a claim is covered, the insurance carrier provides a “defense” to the claims as well as an “indemnity” if liability is found
 - Typically, the insurance carrier selects legal counsel
 - Typically, these policies are “burning limits” policies
 - As defense costs are incurred, the amount of coverage is reduced

Professional Liability of the Construction Manager

- Questions?