



Barry LePatner's book on the perilous state of our nation's infrastructure will be published in late October. Look for further announcements...



LEPATNER REPORT

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FIRM NEWS

+ If you haven't read our white paper on planning and managing your construction projects for a true, complete price, go to www.lepatner.com and click on the link to our **LePatner C3 Model: Construction Cost Certainty for Owners**. The paper outlines the right way to strategically plan, manage, contract, and execute a project in order to remain on budget and on schedule. Check out the FAQs as well. Help us end fast-track projects and cost overruns forever! Send any feedback and questions to bcronk@lepatner.com.

+ Two recent articles in **The Real Deal** confirm from construction industry leaders what we've been telling our clients all along: that contractors systematically underbid to get a project only to run the costs up after they've signed the agreement. We have a different way: the LePatner C3 Model. See the articles [here](#) and [here](#).

+ According to Bill Clements of **Finance & Commerce**, Barry LePatner's soon-to-be-published book belongs in the horror genre. He writes, "The title, **Too Big to Fall: America's Failing Infrastructure and the Way Forward**, isn't exactly horror-inducing, but what it tells us is: Some 7,980 bridges are considered as perilous as the I-35W bridge was before it collapsed, killing 13 and injuring 145." Link to the article [here](#).

+ Barry LePatner published "Infrastructure Focus: Recognizing a Crisis" in the August issue of **Construction Today**, a trade journal that publishes the latest in project delivery best practices, new technologies, market trends and training techniques. Link to the article [here](#).

+ The **Commercial Observer** selected Barry LePatner as one of "The Lawyers You Call" for real estate and construction counsel. Read about it [here](#).

QUOTE OF THE QUARTER

Determination brings the strength to continue, the steadiness to succeed, and the wisdom to slip past difficulties undisturbed.

Curbing Deficient Construction Practices in Hospital Projects

By Henry H. Korn, Esq.

In April of this year, a federal grand jury in Manhattan indicted a former Mount Sinai Medical Center purchasing agent for his alleged role in bid-rigging related to certain maintenance and construction contracts at the hospital. Unfortunately, these situations are not infrequent in hospitals where inadequate construction management oversight is often the norm. But there can be severe repercussions for major metropolitan health care systems when internal audits reveal irregularities and deficiencies in their hospitals' internal construction project controls, or lack thereof.

Hospitals are one of the most complex and costly buildings to design and construct. But hospital leadership typically assigns construction management oversight to their facilities departments, who are often already stretched just managing day-to-day operations. As a result, change orders and project delays frequently occur, exposing the hospital to unforeseen additional costs to their capital budgets.

Based on forensic construction investigations that LePatner has undertaken for trustees of major New York City based hospital networks and interviews with their executives, we have found that:

- Facilities employees are unaware of or do not follow in critical respects hospital construction policies. This includes their failure to: (a) pre-qualify trade contractors; (b) employ a transparent and fair bidding process; (c) provide credible bid leveling and analysis; (d) obtain required project documentation, including signed contracts; (e) follow standardized procedures for invoice payment, change order authorization, and sign offs; and (f) obtain proof of contractor insurance.
- Decision-making responsibility is diffused and unclear;
- Information flow is informal and incomplete;
- Expert advice is not sought or effectively utilized;
- Improper financial transactions adversely influence contract awards;
- Costly change orders are paid without proper documentation and approval;
- Projects are consistently delayed well beyond the contract period exposing the hospital to substantial claims;
- Senior hospital construction personnel do not adequately adhere to filing laws and regulations with respect to Certificates of Need ("CON") and amending such CONs when construction problems impact the cost of construction.

► The intense New York State regulatory environment magnifies the adverse consequences facing hospitals when they allow such deficient construction management practices. Hospital executives tasked with overseeing construction projects should be aware of the critical role that construction counsel and specialized forensic auditors can play in protecting the hospital from State investigations prompted by improper construction practices.

New York State Certificate Of Need Program

New York State has one of the most detailed and rigorous CON programs in the nation. There are four levels of review for CON approval, which depend on the type of work and construction requested: 1) Equipment Replacement Letter; 2) Limited Architectural Review; 3) Administrative Review; and 4) Full Review.

By law, every medical facility and medical corporation operating in New York must submit supporting documents in its CON application. Under the Department of Health policies, at least 10% of projects must be supported by an equity contribution. The remaining 90% can be financed. A CON application will state the funding structure and will address how the remaining costs will be paid (i.e. leases, fund raising, financing). Most major construction projects (over \$25 million) will be funded by a form of government financing.

...Governor David Paterson has made clear his mandate that OMIG investigate, on a State-wide basis, hospital mismanagement with a view to clawing back huge sums paid to hospitals that fail to control waste in Medicaid and related spending.

A hospital's Medicaid Reimbursement Rate ("MRR") may fluctuate from a base year and trend forward, with adjustments made based upon construction costs, amongst other things. Capital costs, including construction costs, when approved, are built into the hospital's MRR. But, hospital construction undertaken with lax oversight and project controls present the hospital with the real prospect that cost overruns (including kickbacks) will reduce the MRR amount, adversely impacting the MRR for future construction projects while simultaneously exposing the hospital to serious claw back claims by the State's Attorney General.

Current Investigative and Enforcement Efforts

On April 18, 2008, the NY Office of Medicaid Inspector General ("OMIG") released a comprehensive and ambitious plan which discusses OMIG's efforts to investigate Medicaid Fraud. Through OMIG, the Bureau of Investigations and Enforcement investigates individuals, facilities, or entities that bill or are alleged to have billed Medicaid for services not rendered, claims that manipulate payment codes in an effort

to inflate reimbursement amounts, and other false claims submitted to obtain program funds. It will also investigate business arrangements that allegedly violate the federal health care anti-kickback statute.

OMIG is tasked by law to uncover fraud in the healthcare system and has statutory authority to audit hospitals. Additionally, OMIG may recoup overpayments to hospitals and other medical facilities under PHL § 32 and 18 NYCRR § 518.1, if audits uncover evidence that the facility is operated in a manner inconsistent with its approved CON. OMIG is also empowered to impose penalties on non-compliant health care providers, and is empowered to, "develop protocols to facilitate the efficient self-disclosure and collection of overpayments and monitor such collections, including those that are self-disclosed by providers."

OMIG audits could trigger federal review under the Federal-State Health Reform Partnership ("F-SHRP"). We believe that Governor David Paterson has made clear his mandate that OMIG investigate, on a State-wide basis, hospital mismanagement with a view to clawing back huge sums paid to hospitals that fail to control waste in Medicaid and related spending. In the Governor's December 12, 2008 press release, he announced \$551 million in Medicaid recoveries under the F-SHRP program.

For hospitals that have their questionable construction practices come to the attention of the OMIG, an investigation would take in to account the hospital's construction practices, its failure to address problems specified in the system audit, and its failure to detect hospital employees using the construction projects to enrich themselves. Evidence of these improprieties would expose the hospital to severe financial and other adverse consequences. In any such investigation, deficient internal controls and the absence of effective senior management and Board oversight would be of concern to OMIG and DOH and impact the MRR for the hospital.

Adopting Effective Internal Controls

In hospital construction audit cases where we have been involved, the role of counsel and its retained forensic accountants is critical. Promptly after DOH / OMIG systems auditors reported their findings on the hospital's deficient practices, hospital management implemented an effective plan of corrective action to prove to the agencies that the hospital had identified and then deterred further construction irregularities. Internal controls along the following lines were established by third parties in close coordination with hospital executives in order to achieve compliance:

- Define the roles and responsibilities of project managers and third-party advisors and consultants.
- Conduct a detailed risk assessment, ranking the related operating and fraud risks based on their likelihood and potential dollar impact.
- Develop specific actions to mitigate such risks.
- Establish formal guidance and directives to ensure proper authorization, approval and review of change orders, increases in scope during the project and related activities.
- Ensure that employees involved in the construction process have the necessary experience and training.
- Develop a formal process to review, analyze and investigate results that significantly vary from the budget or plan.

By Alex Tuttle, Esq.

- Establish a formal communication process to facilitate the information flow from project managers to senior management.
- Verify that the contractors maintained appropriate insurance coverage and the hospital was protected as an additional insured.
- Confirm that the CM or GC can justify its fees, general conditions, and other expenses.
- Claims for change order work and associated payments by the hospital can be justified.
- Internal controls relating to change order work identifies who has the authority to approve change order work and what documentation is required to justify it.
- The requisition process is transparent so that the hospital, or its representatives, can be confident that every requisition payment reflects work actually completed, that the CM/GC makes payments in full to subcontractors, that funds are not diverted from the project to pay for the expenses of other projects involving the CM/GC, or to pay for the general operating or personal expenses of the CM/GC.
- Lien waivers for the subcontractors, GC/CM are properly prepared and executed to protect the hospital as a condition to payment to the GC/CM and subcontractors.
- All required sign-offs and other closing out documentation for the project are secured by the hospital.

The objective of such professional third-party assistance was to bring structure and discipline to the management and oversight of hospital construction projects. Internal controls ensure that if OMIG reviewed the hospital's activities, there would be a clear record of effective and proactive controls in place to accomplish the following:

- Deter, prevent or detect fraudulent activities in a timely manner.
- Ensure proper communication and evaluation of control issues as they are identified.
- Identify surprises and issues before they get worse.
- Ensure proper disclosure and presentation of the hospital's results as they impact the financial condition of the hospital as well as its compliance with regulatory rules and laws.
- Adverse consequences of delegation of cost controls.
- Importance of active and consistent monitoring and evaluation of construction project internal controls and reviewing related project costs to ensure their validity and accuracy.

Conclusion

In today's capital-constricted environment where unwarranted cost overruns are simply unaffordable, hospital boards and executives as well as public agencies and corporate officials would be well advised to steer clear of managing their construction projects as they may gotten away with in years past. Instead, they must insist that their capital projects be executed with professional "owner-centric" oversight, regulatory-compliant project controls and protocols followed by all, and with true complete-price construction contracts that prevent cost overruns. While hospital facilities departments are staffed by talented men and women, hospital construction is too complex and too important to be relegated to their jurisdiction alone if surprise costs and situations are to be avoided. It takes the right team, and it starts with the right decisions about oversight and controls from the top.

Every so often you find yourself at wits end. Seemingly helpless. Much like accidentally turning into traffic headed in the wrong direction (or maybe that's just me).

Nothing captures this feeling more than being subjected to a construction site next door to your home. Construction is relentless. It is loud. It is messy. Being a neighbor to construction permeates and consumes your life as you endure this torment.

Yet with the right tools and approach, you can recapture control of the situation. You can protect against damage to your home caused by the neighboring construction and against out-of-pocket expenses and excessive legal fees to repair your damaged property after-the-fact.

If you are a homeowner or building owner (especially in New York City) who becomes aware of a sizeable construction project commencing next door, the first effective step is to immediately notify your neighbor and their contractor that protections and safety measures need to be put in place to guard against damage to your property. You should arrange for an engineer or architect to prepare a survey documenting the existing conditions of your property, which should be agreed to and signed by your neighbor and their contractor before they commence construction. You should also insist that you be listed as an additional insured on the contractor's general liability policy and, to the extent possible, on your neighbor's homeowner policy.

Where your neighbor's project involves a gut renovation or foundation work, you have substantial leverage under the New York City Administrative Code to ensure that your neighbor and their contractor deliver these protections. Section 3309 of the Code provides, in pertinent part:

Adjoining public and private property shall be protected from damage during construction or demolition work. Protection must be provided for footings, foundations, party walls, chimneys, skylights and roofs. Provisions shall be made to control water run-off and erosion during construction or demolition activities... Section 3309.1

The responsibility of affording any license to enter adjoining property shall rest upon the owner of the adjoining property involved... Section 3309.2

Accordingly, you are well-positioned to insist that your neighbor enter into a written license and access agreement with you to protect your property before commencing or proceeding with construction. Such an agreement should contain a host of conditions and protections, most of which should ►

▶ be quickly agreed to by your neighbor, since they will be under financial pressure to start construction as soon as possible or face potential additional costs from their architect and contractor for the delayed start. The license and access agreement should include, among other provisions:

1. **An exact description of the scope of work protecting against damages to your property (e.g. vibration monitors, overhead roof protection, etc.) and type of access permitted (e.g. exterior only, roof, etc.);**
2. **A rigid schedule detailing the days of the week access is permitted and work may occur;**
3. **An outside date in which the work must be concluded and access is no longer permitted;**
4. **Representations and warranties by your neighbor and the contractor that:**
 - **the work will be performed in a skillful and workmanlike manner;**
 - **the contractor uses all protective measures and devices necessary to keep your property free from damage and debris from the work;**
 - **the contractor complies with all applicable laws, rules, and regulations;**
 - **your property is kept secure;**
 - **safety precautions are taken to protect visitors to your property;**
 - **they repair or pay for the repair of, at your choosing, all damages to your property to a condition at least as good as before the construction;**
 - **they pay for all expenses and attorneys fees to cure any damage to your property; and**
 - **no work or access may be performed or permitted outside the agreed upon scope of work.**
5. **Liquidated damages (i.e. penalty of \$\$ per day) for access required or work performed beyond the outside date in the schedule;**
6. **Immediate termination of the agreement and access if the agreement is breached;**
7. **A full defense, indemnification, and hold harmless from and against any claims by third-parties; and**
8. **An insurance representation (perhaps the most critical), listing you as an additional insured under their insurance policies, which is primary to your homeowner policy.**

While these should be the key provisions to any license/access agreement, they are only as good as how well they are monitored and enforced. Damages can surface suddenly and dramatically. Your neighbor (including their contractor and architect), its insurance carriers, and their attorneys must be notified of these damages in writing. Your legal counsel and homeowner's insurer must be notified also. The damages must be documented immediately and reviewed by your experts to determine cause and effect, including damage that impacts the safety and habitability of your home or building. You will need to

seek and obtain proposals from consulting experts and contractors and coordinate in-depth with the insurance representatives to facilitate the corrective work. Ideally, you will have identified and vetted these experts as soon as you become aware of your neighbor's construction, so that if damage occurs, your experts are familiar with your building and can respond as quickly as possible.

Without contractual assurances and vigilant oversight of your neighbor's construction, you may have little recourse in the event your property is damaged or the construction is delayed (no one wants a sidewalk shed covering their property any longer than necessary). Without a signed license/access agreement, you will likely dig deep in your pockets (without reimbursement) to pay for effective legal counsel, who may be hard pressed to prove that the damages were caused by the neighbor's construction. Too often, our firm is retained as construction counsel by the owner after his or her property has already been seriously damaged by their neighbor's construction. While it would not be too late for the client to ultimately obtain some compensation, it would likely be a lengthy and expensive uphill battle to get it. Some foresight and up front planning will make a difficult situation much easier to manage and provide greater certainty that the neighbor will be legally and financially responsible for making you whole.

We are not always in control of our fate. We don't get to pick our neighbors. We don't have a say in their grandiose dreams of building their "perfect home". But we can pull back the reigns and instill strict parameters through contracting and oversight where their work would directly impact your property. With the right license/access agreement in place, we can pull them hard if necessary.

If you would like further information on this topic, please contact Alexander Tuttle at atuttle@lepatner.com.

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