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{Caveat Advocatus}

DRAFTING CONSTRUCTION PROJECTS FOR YOUR CLIENT'S NEW CONSTRUCTION PROJECT AIN'T WHAT IT USED TO BE

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The annual value of construction for buildings of all types in the United States is \$1.163 trillion.¹ In the New York metropolitan area, construction for public and private, residential and commercial use for the year 2005 totaled \$18.4 billion.² Over the past fifteen years, the average cost of most large projects in major cities has grown between 20-30%.

With the complexity and cost of construction on the rise, owners and developers have increasing concerns that the risks for them and each of the team members retained for a project are clearly understood and defined in their project agreements.³ Consequently, today's construction projects require sophisticated agreements with provisions advanced far beyond the standard form agreements traditionally utilized by most law firms, developers and corporate and institutional builders.

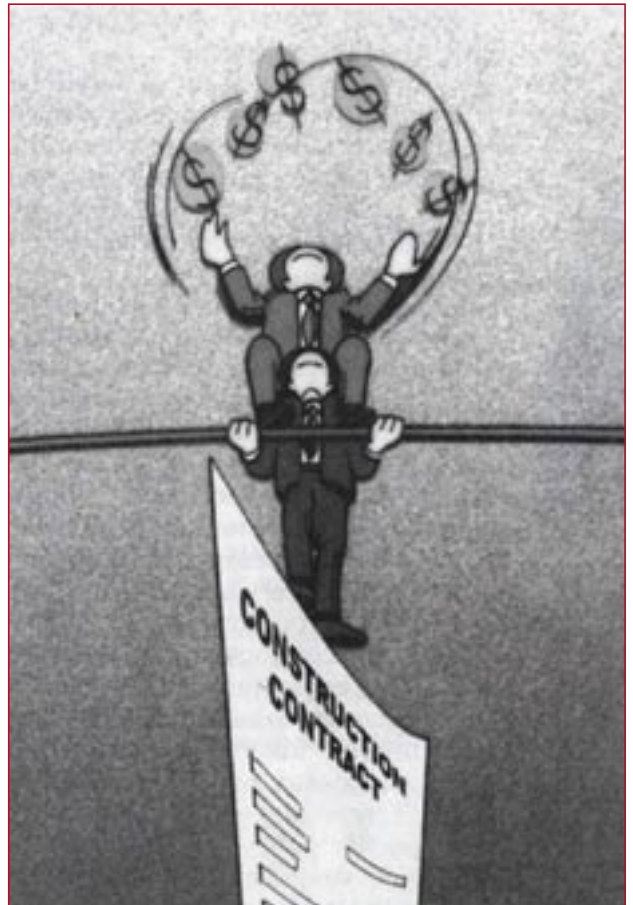
The reasons for this advancement are threefold in nature. First, construction projects, from school buildings to hotels, from office towers to residential high rises to hospitals to shopping complexes, involve teams of specialized, highly talented design and construction professionals that are called upon to integrate and coordinate their efforts to achieve the owner's objectives.

Second, the manner and means by which today's complex project is designed and constructed is no longer fully reflected in the widely utilized standard form agreements.

Third, and perhaps most significant for those who draft these agreements for owners, standard agreements fail to properly allocate risk amongst team members and places upon the owner disproportionate risk as the ultimate guarantor of unallocated uncertainty.

The modern construction process makes it ill-advised – and some would even say an act of malpractice – to utilize standardized form agreements for any but the most simplistic project. Owners should instead require counsel to draft agreements that recognize the myriad of issues they face as they plan and execute the design and construction of their projects. These issues include, among others:

- The requirement to comply with a diverse and increasing number of governmental and community agencies having jurisdiction over a project and ensuring that team members properly address and resolve the often conflicting codes, rules and regulations of these agencies to ensure avoidance of costly delays;
- The need to understand a host of new insurance coverages that protect against such risks as: latent hazardous environmental materials found on site, collapse of buildings undergoing renovation or repair; insufficient coverage for design team members; and property damage during the construction process that can be insured by builder's risk coverage;
- The increasing use of evolving technologies such as Building Information Systems that incorporate design, fabrication, installation and post-occupancy operational information on the design documents which require enhanced coordination by and between project team members;
- The growing use of new products and building systems from abroad that can, if not adequately provided for in the contracts of all concerned, result in shipping and customs delays at



security-conscious ports upon arrival from overseas;

- The widespread use by construction managers of new and inventive mechanisms for padding contingencies and invoicing the owner for the all-important and costly general conditions, i.e., overhead, insurance and related line item costs that must be carefully examined on a line-by-line basis; and
- The critically important need to implement measures to ensure and maximize post-9/11 security protections in public and private projects from the outset of the design phase.

BEWARE FORM AGREEMENTS

The decision to use a standard agreement assumes that the owner's project is "ordinary" and that counsel believes a form agreement with the amendments that are customarily attached to these forms irrespective of the complexity of the project will fully protect the owner's interests.

Architects, engineers and construction executives will uniformly agree that each project is unique. Every project has its own litany of business objectives, design parameters and construction exigencies that must be addressed, accommodated and overcome for the project to meet its objectives, primarily that of completing the building on time and within budget.

The widespread use of pre-packaged agreements issued by the American Institute of Architects has made it all too easy for real estate and corporate counsel to rely on them as the standard of the industry. Proponents of the forms typically point to the fact that these forms are regularly promulgated by architects, engineers and contractors who are familiar with the forms and understand and readily accept them – even as they may be modified by counsel for the owner.

The reality is that these standard forms are the amalgamation of several misperceptions that are not generally disclosed to the building public or their attorneys.

There is no owner group that is consulted with respect to the issuance of these forms. ⁴ In fact, no AIA form can be issued until it has been reviewed and signed off by, of all things, the Association of General

Contractors, the most prominent national trade organization for the construction industry.⁵

As a result, numerous protective provisions i.e. provisions that protect the interests of the design professional and contractor make it possible for the construction team to assert costly claims against the owner, are manifest throughout these AIA form contracts. They do little to protect the interest of the party to a project that is most at risk – the owner who has paid for or leased the property to be developed, secured the funding for construction and bears the risk of all uncertainties.

Private owners have no cohesive professional association and hence no standard contract forms. This is because no private owner orders the construction of enough buildings to induce builders to adopt a more balanced risk form of agreement. In truth, the standard form agreements have long outlasted their value in the design and construction process. Consider that the "fast track" form of designing and constructing a project, while now widely utilized throughout the nation, is not reflected whatsoever in any AIA standard form.⁶

For most owners and their counsel who do not regularly negotiate these agreements, sitting across the table from sophisticated construction managers and their attorneys can be an unsettling experience. Negotiating the nuances of a "fast track" or "design build" process with "multiple bid packages" or understanding the intricacies of the various line items that compose the contractor's costly "general conditions" can be a daunting experience, especially when the construction manager uses the tried and true statement that "this is how we did it on the last five projects." It is at this point that an owner needs to have its representative lean across the table and utter the magic words: "Just because you were able to double up your costs on those projects is no reason why this owner should pay them."

IT'S A CHANGED WORLD

There was a time when standard agreements served a valid basis for the performance of the work, labor and services on a project. As late as the 1980s, building a high rise

tower, a hospital, school or any other non-residential project was largely a straightforward effort undertaken by traditional methodologies.

The architects and their consultant engineers prepared the design documents in a design-bid-build sequence that dated back to the late 1800s. The contractor or the construction manager then would bid on the design documents. The lowest bidder was awarded the contract for construction. Project costs rarely exceeded \$75 million and insurance was available in the market to cover many of the open variables that an owner might encounter.

All this changed dramatically by the early 1990s. Increased costs of construction materials and labor, the widespread introduction of new technologies such as computer aided design software, and the advent of globalism that introduced designers, products and contractors from abroad to the U.S. construction world all radically altered the construction landscape.

The use of new and expressive design concepts in architecture today requires an understanding by counsel of the fundamental changes in the roles of the parties called upon to develop, design, fabricate and install the many new and exciting designs that are part of the selective and strategic objectives of the owner. It is these objectives that must be identified and integrated into each of the agreements for the project in order to protect the owner.⁷

Architects such as Frank Gehry, Richard Rogers and Norman Foster design some of the world's most elaborate and elegant buildings. The designs they produce must be carefully calculated to meet exacting code and design criteria standards. These require materials such as glass and titanium to perform to specifications that are then carefully fabricated to exacting tolerances.

How the construction team interfaces with these computer-generated designs is far removed from the traditional methods used in the past. Standard agreements do not address these methodologies. This leaves major inconsistencies and omissions in the form agreements used by counsel that expose an owner to increased claims for delay and extras.

In fact, the AIA has stated that it will not have any new proposed forms to be reviewed by the industry until some time in 2007!

Environmental sustainability issues are beginning to pervade the designs of all architects and engineers. The use of sustainable systems, materials and their application, usability and the warranties attendant to their use are areas of special concern to the drafters of agreements where such products are to be included. Special code requirements must be referenced in the project agreements to ensure compliance with these complex regulations.

The entire subject of insurance for complex projects has become a specialized world that can undermine any project. No longer are there standard coverages for counsel to “plug into” an exhibit.

The purpose of this article is not to burden the reader with reference to whether an OCIP (an “owner controlled insurance program”) or a CCIP (a “contractor controlled insurance program”) would best serve the interests of the owner. But it is vitally important that counsel actively assist the insurance

team in defining the extent of insurance for critical areas of the project, such as the builders risk policy that must interface with the requirements of the lender or, if a project entails renovation of an existing facility, the correct application of coverages for potential collapse of the existing structure.

It is critical that the owner be correctly endorsed as an additional insured on team member coverages. Likewise, critical indemnification provisions must be coordinated to fully protect the owner from many, if not most, construction risks.

SAMPLE TROUBLE SPOTS

The nuances of drafting the owner-architect agreement can be highlighted by

reference to what is referred to in Section 1.3.2 of the standard AIA B141 agreement as the seemingly innocuous “Ownership Use and Copyright” provision. Counsel’s inclusion of this provision appears simple enough. It states:

Drawings, specifications and other documents, including those in electronic form, prepared by the Architect and the Architect’s consultants are Instruments of Service for use solely with respect to this Project. The Architect and the Architect’s consultants shall be deemed the authors and owners of their respective Instruments of Service and shall retain all common law, statutory, and other reserved rights and copyrights.

The widespread use of pre-packaged agreements issued by the American Institute of Architects has made it all too easy for real estate and corporate counsel to rely on them as the standard of the industry.

By virtue of the Architectural Works Copyright Protection Act of 1990, this provision extends copyright protection not only to the design of the building, but to the design that the building embodies.⁸

As a result, unless otherwise modified by astute counsel, the architect, and by extension each of the designers and engineers on the project – of which there may be as many as a dozen,⁹ -- retain full proprietary rights to their design documents. This would give them the right, in the event of a dispute over services during the project, to walk off the job with the design documents and preclude the project (despite how many tens or hundreds of millions of dollars spent by the owner) from moving forward.

Today, to grant the designers of a

complex project such vast rights to control the progress of a project in the event of any kind of dispute with the owner is tantamount to giving them control of the project -- something no owner would wish to cede and certainly no lender would permit. Yet, our office continues to address disputes involving millions of dollars where the owner is held hostage by virtue of having conceded the ownership, use and copyright provision to an architect or other designer.

Similarly, counsel often leave in the standard dispute resolution provision found in all AIA agreements, the requirement that all disputes be resolved through mediation and/or mandatory arbitration before the American Arbitration Association. Consolidation and/or joinder of all team members is not always required in the form agreements.

Just as significantly, the all-important issue of securing discovery of project documents from team members rests exclusively with the arbitrators.

The vast breadth of claims that emanate from a project can include problems that can simultaneously involve the architect, one or more of the engineers, the construction manager and one or more of the

subcontractors. As a result, in the event of a dispute counsel will need to obtain and review the project documents from each of the parties involved.

Agreeing to arbitration will limit discovery of critical evidence. As any litigator knows, full access to all project records, including electronically maintained data in their original format is essential. Courts routinely provide such discovery; arbitrators may not always permit it.

The mere thought that an owner could find itself addressing the same dispute involving construction defects or delays totaling millions of dollars via separate arbitrations against the architect and the construction manager is a predicament to be avoided at all costs.

In order to ensure consolidation and/or joinder in contemplation of resolving all disputes among the construction and design team members in one forum, the agreement should provide for the joinder of all these parties in the dispute resolution procedure established in the agreement. The agreement should also require the contractor and the architect to provide for the joinder of these parties in their respective agreements with their subcontractors and consultants.

The contractor and architect should also agree to being joined in any arbitration proceeding arising from claims resulting from the services performed under their respective agreements. Today, any drafter of an owner's design or construction agreements that permits mandatory arbitration of construction disputes has failed his or her client.

CONCLUSION

As construction projects have become increasingly more complex and costly the owner's counsel in the construction process must ensure that the risks borne by the owner are not increased by ceding important issues to other team members. There is no better defense to unwarranted claims or extras or more opportune time to secure protections for the owner than with a well-prepared agreement each project participant.

Moreover, enforceability of an owner's rights, both during the project as well as in any dispute arising therefrom, is made immeasurably more certain if the proper agreement has been negotiated at the outset of the project. The known risks to an owner can easily exceed the tens or hundreds of millions of dollars spent on the project. Counsel for the owner can negotiate these risks more proactively by requiring each of the relevant parties to assume their respective share of project risks. Any other approach should be avoided at all costs.

ENDNOTES

¹ U.S. Census Bureau News, U.S. Department of Commerce release, March 1, 2006, www.census.gov/constructionspending; Also see, Alex Frangos, "Construction Sticker Shock—Optimism, Pricey Materials Help to Fuel a 10% Leap in the Cost of a New Building," *Wall Street Journal*, March 23, 2005.

² Building Congress Construction Outlook Report, Winter 2005 Update.

³ Alison Gregor "Construction Cost Going Up," *The Real Deal*, August 2005, V3#8.

⁴ Barry B. LePatner, "Riders in a Storm," *Architecture*, (February 1999), and Barry B. LePatner, "Seeing the Light," *Architecture*, (March 1990).

⁵ The first page of AIA document A201, the most widely used AIA Form and the document that sets the general terms under which projects are governed, states on its face that "**This document has been approved and endorsed by The Associated General Contractors of America.**"

⁶ The AIA Forms (A111, B141) allow for the insertion of a reference to utilization of a "fast-track" method of construction but offer none of the substantive provisions required to give effect to an owner's "fast-track" goals.

⁷ Public agencies have defined needs that must be incorporated into their construction documents. See e.g. "Balancing Interests in Construction Contracting", *American City and Country*, March 1, 1995.

⁸ Peter S. Britell and Joseph M. Donohue, "Architect Agreements: Ownership Rights of Drawings Can Trap the Unwary," *New York Law Journal*, March 10, 2004.

⁹ If the reader is surprised by this enumeration one can begin with the architect and go on to cite the structural engineer, the mechanical, electrical and plumbing engineers, the lighting designer, the landscape architect, the audio/visual designer, the kitchen designer, et al.

IN LUMINAE

The following brief quiz will acquaint counsel with a few of the many issues that must be addressed in preparing the various agreements for a project.

Are you confident of the answers to the following questions?

1. Who owns the copyright on the construction documents, and what difference does it make?
2. What effect does a mutual waiver of consequential damages have on the ability to recover delay damages?
3. Are Certificates of Insurance sufficient to provide assurances of coverage to the owner?
4. Can the Architect, consultants, or contractors hold the project hostage pending the resolution of a dispute?
5. Who is ultimately responsible for construction document coordination? The architect? The construction manager? Or both?
6. What fiduciary and audit rights does an owner have vis-à-vis its project team members?

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