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CONSTRUCTION LAW

Construction Management Agreements: CM Liability



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This is the last part of our current series of articles on construction management agreements (CMAs). In this article, we discuss the liability of construction managers (CMs) under provisions of CMAs as they pertain to the construction phase of the project. For the purposes of this article, we use the guaranteed maximum price (GMP) form of CMA.

Liability of the Manager

Fundamentally, the construction manager is responsible for the performance of the work in accordance with the contract documents, consisting of: the CMA; the plans and specifications prepared by the owner's design team; and the scopes of work of the subcontractors. The CM is also responsible to deliver a complete and integrated project; coordinate and cause the work to be complete and corrected by its

subcontractors; maintain job site safety; and ensure compliance with applicable codes, rules and regulations. (While the CM is primarily responsible to cause the work to be performed by the subcontractors, the CMA should provide that the owner is a third-party beneficiary of the subcontracts.)

Counsel for construction managers generally object to a broad indemnification provision, arguing that it is not covered by insurance (which is usually correct); however, in order to provide an owner with full protection, a broad indemnity should be demanded.

The liability of the CM to the owner also extends to claims of third parties, such as: subcontractors; employees of subcontractors; neighbors; and governmental agencies, which claims are subject to the indemnification provisions discussed below. Finally, the work under the CMA is

to be performed within the GMP and strictly in accordance with the project schedule, as may be modified under the terms of the CMA.

Owner Remedies

The owner has several remedies in the event the CM fails to perform its obligations under the CMA, including withholding portions of the CM's applications for payment; back charging the CM for the cost incurred by the owner to complete or correct the work; ordering an acceleration of the work if the project schedule is not being met (e.g., utilizing overtime or additional shifts); and, ultimately, termination of the CMA. In all events, the CM bears the cost of these remedies where it is at fault, but where appropriate, the CM will have access to the CM contingency to offset these costs.

When asserting any of these remedies, care should be taken by the owner to meet the notice requirements of the CMA and, where applicable, the performance bond posted by the CM. In this regard, when drafting CMAs,

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we recommend keeping notice of claim requirements by the owner to a minimum, as distinguished from AIA forms, which require notices of claim before an owner can pursue remedies against the CM.

Likewise, where applicable, the form of AIA performance bond (AIA Document A-312) should be modified to lessen its multiple notice and termination requirements. The owner should be able to seek relief under the bond by giving a one-step notice of default; there should be no requirement for the termination of the CMA. Where the CM is maintaining subcontractor default insurance, upon demand from the owner, the CM should file a claim under the policy, which CMs are sometime hesitant to do because of the deductible and copayment obligations of the policy.

Owner Damages

Depending on the type of liability incurred by the CM for breach of the CMA, the owner may recover actual, consequential or liquidated damages. Actual damages consist of the direct costs incurred as a result of the CM's breach of the CMA, such as unreimbursed costs incurred by the owner in excess of the GMP; costs to remedy defective or incomplete work; and the costs of consultants arising from delayed completion. As noted above, the CM will first have recourse to its contingency to account for these claims; however, once the contingency is exhausted, the CM will bear the cost of these damages,

Consequential damages consist of, typically, loss of income or other non-project expenses incurred, also arising from delayed completion. Consequential damages may also consist of claims of third parties, such as neighbor claims for monetary losses. While it is instinctive for CM counsel to seek a waiver of consequential damages, owners should do so cautiously; if such a waiver is given, the owner may be precluding itself from recovering losses due to the assertion of third-party claims and which may undermine the indemnification provisions of the CMA.

Liquidated damages are usually intended to compensate the owner for late completion and are generally tied to the damages the owner will suffer for delay, such as the lost income, financing costs and taxes. Indeed, in order to be enforceable, the amount of liquidated damages must bear some relation to the *actual* damages the owner will suffer from delay. Contrary to a common misconception, a bonus to the CM for on time or early completion is not a requirement for the enforceability of liquidated damages.

Indemnification and Insurance

In order to protect the owner against the claims of third parties arising from the acts or omissions of the CM, the CMA should include a broad indemnification provision covering not only personal injury and property damage, but third-party claims seeking monetary recoveries, such as claims of neighbors arising from

interference with their business operations as a result of the CM's activities in violation of the CMA; claims of subcontractors and suppliers for monies due; and fines and violations issued by governmental agencies. Counsel for CMs generally object to such a broad indemnification provision, arguing that it is not covered by insurance (which is usually correct); however, in order to provide an owner with full protection, a broad indemnity should be demanded.

An indemnification provision is also necessary to trigger the CM's general liability insurance, which should cover injuries to the CM's and its subcontractor's employees; injuries to other third parties; physical damage to the project during and after construction damage to adjacent property; damage to the CM's equipment; and damage caused by construction defects. The CMA should contain detailed insurance requirements for the CM, name the owner as an additional insured and waive subrogation against the owner. The additional insured status allows the owner to enjoy the benefits of being an insured under the insurance policy, even though it was purchased by the CM. The waiver of subrogation precludes the insurance carrier from seeking to recover contribution from the owner in the event it pays out a claim. (Other principles will apply should the CM or owner procure wrap-up policies for the entire project.)