

## Real Estate, Title Insurance & Construction Law

### Project Owners Need Construction Lawyers Too

By Robert E. Schiappacasse

Most attorneys who list “construction law” as an area of primary practice would also list contractors, not project owners, as their clients. This makes sense. According to a December 2010 report from the United States Department of Labor, Bureau of Labor Statistics, there were almost 900,000 construction firms in the United States in 2008. Multiple construction firms come to each project as contractors and subcontractors with specific interests and concerns, and lawyers focused on those interests and concerns, so as to maximize their profit and limit their risk at the expense of one owner.

The owner of a construction project, on the other hand, is typically a public or private entity that requires construction as a means to an end. The public sector owner is a government body or agency, like a school district that wants to build

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*Schiappacasse is a corporate attorney at Sills Cummis & Gross, where he focuses his practice on commercial real estate and serves as general counsel to a number of heavy construction contractors. The views and opinions expressed in this article are those of the author and not necessarily those of the firm.*

a new school, or a county or state government that needs to repair a bridge or pave a highway. A private sector owner may be a real estate developer looking to construct a strip mall or office building, or an individual looking to build his or her dream home on a parcel of land. Unlike contractors who are in the business of construction, most owners are in other businesses and only require construction to accomplish other goals. That is why it is critical that an owner, especially one without much experience with construction of a project, has experienced construction counsel to best protect its interests.

That protection, in all cases, must start with the main agreement between the owner and the general contractor. This agreement should address all of the terms of the arrangement between the owner and the general contractor, and foresee and address potential risks so that responsibility and liability can be fairly allocated. But an owner can go a long way in minimizing its risk by understanding issues related to price and insurance on a construction project, and making sure the agreement reflects that understanding.

Day after day, we read about construction projects, big and small, that cost the owner far in excess of the initial budget for the project. For example, the construction of the new football stadium

at the Meadowlands was initially projected to cost approximately \$800 million. The final cost of construction came in at approximately \$1.4 billion. One main reason owners find themselves in this situation is because many owners choose to solicit and award bids for construction projects, and start work, before the construction plans are fully completed and coordinated by architects, engineers and other members of the design team. So, the result will be numerous additions and revisions to the project which come to light once the plans are completed and after work has commenced. Those revisions and additions will subject the owner to additional costs.

An owner can try to address this issue in the agreement in several ways. One possibility is to make sure the plans used to bid the project are as complete as possible. If the general contractors bidding on the work are forced to bid based on fully complete construction plans, then the owner is in a position to negotiate a true “fixed price” contract, subject only to certain conditions. This will limit the ability of the general contractor to increase costs through change orders for work not shown on the original plans. In the event an owner cannot afford to wait for the completion of construction plans before bidding and starting the work, then the

agreement must include protections for the owner to deal with the change order process. The agreement should include a structured dispute resolution mechanism by which any issues with change orders can be resolved quickly. Also, assuming the issue in dispute is not the actual scope of work, the contractor should be required to proceed with the work while resolution of the dispute is pending so as to avoid unnecessary delays. It is critical for an owner, and owner's counsel, to understand that even if the form of contract calls itself a "fixed price" contract, or a "guaranteed maximum price" contract, it is not truly a set price unless it is based on complete construction plans.

Insurance is another important component of any construction project which must be coordinated with the terms of the agreement between the owner and general contractor in order to provide the owner with protection against unforeseen liability. Of course, as in most contracts, the insurance provisions in a construction contract should detail the types of insurance each party is responsible to obtain, the required limits for that insurance, and the parties to be insured and named as additional insured. Additionally, if the project warrants, an owner may require the general contractor to bond the project for payment (to subcontractors) and performance as an additional layer of protection. But understanding the types of insurance necessary for a particular project is a critical first step.

The insurance requirements of an owner will vary depending on the type of the project. For example, an owner that is having the interior of Class A office space

fit out will likely not need insurance for the collapse of the building. Likewise, the owner of a project that requires a large area to be excavated for foundation and subsurface structures may want insurance to protect against the discovery of contamination or hazardous materials at the project site. Understanding the insurance requirements for a project is just as important for making sure the owner is not paying for insurance it doesn't need, as it is in making sure the owner has all the coverage necessary for the risks associated with that type of project. An owner must also take into account the type of insurance being required by the lender, if any, and incorporate those requirements into its own insurance program and that of the general contractor.

Counsel should also be sensitive to clauses in which the owner is asked to waive any rights of "subrogation." Under the subrogation clause of an insurance policy, the insurer has the right to take legal action against a third party responsible for a loss to an insured for which a claim has been paid. If an owner is going to assure a general contractor under the agreement that the general contractor will not be liable for certain damages, such a waiver needs to be approved by the insurance carrier. Otherwise, the insurance carrier can still pursue the general contractor and may also subject the owner-insured to penalties from its insurance carrier.

Price and insurance are but two of many components of a construction agreement which must be understood by the owner and its counsel to ensure that the agreement between the owner and general contractor is drafted in a way to best protect

an owner. It is also important to remember that an owner will have agreements with members of the design team, like architects and engineers, and other members of the construction team, like a construction manager. Those agreements will also require the owner and its counsel to understand the unique issues that arise between an owner and those team members, and must also be coordinated with the main agreement between the owner and general contractor to best protect the owner from exposure due to gaps in risk allocation and items like insurance.

No two projects are alike. Each project includes a different property with different owners and different contractors agreeing to construct different improvements. As such, the use of "forms" can be hazardous. While some clients (and attorneys) think that starting with a form is more efficient, it can also be dangerous unless the attorney working with the form is able to recognize the modifications and additions to the form that might be necessary to protect that particular owner. Also, forms tend to be slanted in favor of one party or another. The AIA form, for example, is created by the American Institute of Architects and is approved by a trade association of contractors. Hence it is not an "owner friendly" form.

Given all that owners have at risk in any given construction project, it is important for owners and their advisors to recognize that a construction contract is not "just another contract." Experienced construction counsel may be the difference between a successful project and significant unforeseen exposure. ■