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CONSTRUCTION LAW

Liability of Construction Managers: Look to the Contract



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In the last several years, construction managers have taken on an increasingly larger share of construction projects. Unlike general contractors, which are generally at risk for all aspects of the project—from cost to schedule to the quality of the work—the risk and responsibility of a construction manager can vary greatly from project to project, depending on the nature of the contract. In this article, we will explore the key aspects of construction management agreements and present a sampling of relevant judicial holdings.

The hallmark of construction management is the total participation of the manager in the construction process, often beginning with the conceptualization of the project. The construction manager will work with the owner and the design team to produce a coordinated and cost efficient set of construction documents. The construction manager will then assist the owner in selecting subcontractors (or trade contractors) and, to varying degrees, coordinate and administer the actual construction.

Generally speaking, construction managers act either in an advisory capacity, as agent for the owner, or as a constructor, acting as an independent contractor, much like a general contractor. When acting as advisor, the construction manager will enter into trade contracts as agent for the owner; as a constructor, the construction manager will enter into contracts directly with subcontractors. The construction manager's contractual liability varies drastically depending on the nature of its employment.

As an advisor, the construction manager is, essentially, liable only for its own acts of negligence or breach of contract. It is not considered to be

acting "at risk" with respect to the cost, time or quality of performance by the trade contractors. Acting as a constructor, the construction manager is generally responsible for the construction of the project; however, the construction manager's ultimate liability for the key elements of the project—cost, schedule and quality of the work—can vary greatly based upon its agreement with the owner.

Obligations of the Manager

Perhaps the only universal statement that can be made about the obligations and liabilities of a construction manager is: "it depends upon what it says in the contract." As with almost any other legal relationship, the rights and obligations of the construction manager (to the owner, to trade contractors and to third-parties) are controlled primarily by the language of the respective agreements. While there are certain statutory and common law rules regarding what can and cannot be included in construction contracts, very few generalities can be made.

When the construction manager is acting only as the owner's advisor—also known as pure construction management—the construction manager typically does not assume any responsibility for the cost, time or the quality of the work. The construction manager may, as part of its contract with the owner, agree to prepare estimates of the cost of the work, but the estimates are typically not guaranteed. The American Institute of Architects most current Standard Form of Agreement Between Owner and Construction Manager as Adviser (AIA Document C132-2009) specifically provides that "the Construction Manager does not warrant or represent that bids or negotiated prices will not vary from the budget proposed, established or approved by the Owner, or from any cost estimate or evaluation prepared by the Construction Manager." (AIA Document A132-2009 §6.2).

The construction manager as advisor may, of course, assume greater responsibility for the cost of the work, but will typically insist on additional compensation to reflect that added risk and will insist upon adequate contingencies in its estimates to account for potential cost overruns and unforeseen costs.

The construction manager acting as constructor will be liable for the cost of the project if it agrees to perform the work for a guaranteed maximum price (GMP) or a lump sum. This is not the case where the agreement is structured on a "cost plus" basis. Under a cost plus arrangement, the construction manager is reimbursed for all costs of the work and is paid a fee, generally determined as a percentage of the cost of the work. Under a GMP, the construction manager will guaranty the total cost of the project, which includes its supervisory expenses and subcontract costs (usually based on drawings which are 80-90 percent complete). A major component of a GMP is the establishment of a contingency, usually 3-5 percent of the subcontract and general conditions (e.g., supervisory expenses) costs. The construction manager can utilize the contingency to offset the cost of, for example, bid error, defective work, subcontractor defaults, scheduling conflicts, delays, etc.

Where the construction management agreement provides for a GMP, there is often an arrangement for the sharing of any savings between the owner and the construction manager if the final cost of the work is less than the GMP. Where there is a sharing of savings, any unused contingency might likewise be shared. (The sharing of savings both from the GMP and the contingency involves detailed business negotiations which are project specific.)

The construction management agreement will also determine the construction manager's liability for completion of the project in accordance with

an agreed upon schedule. Generally speaking, as a constructor, a construction manager is responsible for completing the project on time and may be responsible to the owner for damages incurred as a result of delay. The extent of the damages—whether they be liquidated, direct or consequential—is a function of the terms of the construction management agreement. Even in the absence of liquidated damages for delay, the construction manager may be obligated to maintain the progress of the work in accordance with the project schedule and be responsible for the cost of overtime and additional shifts in order to maintain that schedule. Where there is a contingency, the construction manager may utilize funds in the contingency to cover such additional costs.

As a constructor, the construction manager is also responsible for the quality of the work of its subcontractors. Where the construction manager cannot prevail upon the responsible subcontractor to remedy the defective work, the construction manager will be required to remedy the defects at its expense; however, the contingency would be available for that purpose.

As an advisor, the construction manager only has an obligation to confirm generally that the work of the trade contractors is being performed in accordance with the respective trade contracts. The typical construction manager as advisor agreement will provide specifically that the construction manager is not responsible for and has no control over the means, methods and procedures of the construction and is not responsible for the failure of the trade contractors to perform the work in accordance with the terms of their respective contracts.

Liability to Trade Contractors

The common assumption is that the construction manager as advisor is acting solely as the owner's agent and, under standard principals of agency, is not liable for the obligations of its disclosed principal, the owner.

However, as the Court of Appeals wrote in *Walls v. Turner Constr. Co.*, “the label of construction manager versus general contractor is not necessarily determinative.” 4 N.Y.3d 861, 864, 798 N.Y.S.2d 351 (2005). Simply calling itself an agent may not be sufficient to insulate the construction manager from an obligation to make payment to the trade contractors. The construction manager has to be careful not to create a contractual relationship between itself and the individual trade contractors performing the work. If the contractors are bound to the construction manager for the proper performance of the work, it may not matter that the construction manager has held itself out solely as the owner's agent.

In *Blandford Land Clearing Corp. v. National Union Fire Insurance Company of Pittsburgh, Pa.*, 260 A.D.2d 86, 698 N.Y.S.2d 237 (1st Dept. 1999), a general contractor (claiming to be acting as the agent of the owner) attempted to insulate itself from an obligation to pay subcontractors on a project by including language in its subcontract agreements that read that “[f]or the purposes of payment only, Contractor is acting as agent of Owner.” 260 A.D.2d at 88. The court found that, since the subcontractors owed an obligation to the general contractor to perform the work, there must be the corresponding obligation on the part of the general contractor to pay the subcontractors for the work.

While *Blandford* involved a general contractor, as opposed to a construction manager, there is no reason to think that the decision would be different if a construction manager signed the contracts as the owner's agent. The lesson to be learned is that in order for the construction manager to insulate itself from any contractual obligation to make payment to trade contractors, it must not enter

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into direct agreements with the trade contractors.

When the construction manager is acting as the constructor, it is typically assumed the construction manager has the direct obligation to make payment to the trade contractors for the performance of the work. This duty is ordinarily independent of the owner's obligation to make payments to the construction manager, and the construction manager has a payment obligation to the trade contractors irrespective of whether the construction manager has received payment from the owner. *West-Fair Elec. Contractors v. Aetna Cas. & Sur. Co.*, 87 N.Y.2d 148, 638 N.Y.S.2d 394 (1995) (a provision in a subcontract that provides that the general contractor is only required to pay the subcontractor if the owner pays the general contractor—a so-called pay when paid provision—is unenforceable as against public policy).

Liability to Third Parties

With respect to tort liability, a construction manager's liability to third parties depends both on the role that the construction manager assumes and the ability of the construction manager to control the activity that caused the injury.

In the pure construction management scenario, where the construction manager does not have control over the performance of the work of the

contractors, the construction manager is typically not liable to third parties for injuries resulting from the work. A construction manager “may nonetheless become responsible for the safety of the workers at a construction site if it has been delegated the authority and duties of a general contractor, or if it functions as an agent of the owner of the premises.” *Pino v. Irvington Union Free School District*, 43 A.D.3d 1130, 843 N.Y.S.2d 133 (3rd Dept. 2007). The issue arises frequently in the context of claims of strict liability under New York Labor Law Section 240(1), also known as the Scaffolding Law.

In *Walls*, the Court of Appeals held that “[a]lthough a construction manager of a work site is generally not responsible for injuries under Labor Law § 240(1), one may be vicariously liable as an agent of the property owner for injuries sustained under the statute in an instance where the manager had the ability to control the activity which brought about the injury.” 4 N.Y.3d 861 at 863-864, 798 N.Y.S.2d 351 (2005).

The court found that the construction manager had a duty, under its contract with the owner of the project, to enforce compliance by the individual trade contractors with applicable safety regulations and to direct trade contractors to correct unsafe conditions. The court wrote that the defendant, Turner Construction Co., was not the “typical construction manager,” but was instead the “eyes, ears and voice of the owner.” 4 N.Y.3d 861 at 864. Accordingly, the court confirmed that Turner was vicariously liable as a statutory agent of the owner. 4 N.Y.3d 861 at 864.

While *Walls* and the cases that have followed it appear as an odd deviation from the typical law of agency—that a disclosed principal is liable for actions of its agent performed within the scope of the agency, not the other way around—the decisions make it clear that, at least in the context of Labor Law §240(1) claims, the extent of the construction manager's liability will be dictated by the scope of its authority. Cf. *Kindlon v. Schoharie Central School Dist.*, 66 A.D.3d 1200, 887 N.Y.S.2d 310 (3rd Dept. 2009) (no direct control as to safety matters shielded the construction manager from liability).

The obligations of a construction manager—as an advisor or constructor, as an agent or independent contractor—are a function of the terms of its contract with the owner. So, too, will the liabilities of a construction manager to an owner, subcontractor or third party vary depending on the agreement.