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Construction Management Agreements: The Cost Plus Hybrid


By Kenneth M. Block And Joshua M. Levy

Construction management agreements, where the construction manager (CM) is a constructor acting as an independent contractor, as opposed to an advisor acting as an agent of the owner, traditionally take the form of guaranteed maximum price (GMP) or cost plus agreements. (While stipulated sum agreements can also be used, they are more akin to traditional general construction contracts, without the transparency of "open book" construction management agreements.) There is, however, a third form of traditional construction management agreement (CMA): the cost plus hybrid, which is the subject of this article.

Forms of CMAs

Under the GMP form, the major risk factors under a CMA—subcontract cost, schedule and the quality of the work—are assumed by the CM. Thus, the CM guarantees the total cost of the project, including its supervisory expenses and subcontract costs (usually based on drawings which are 80-90 percent complete). However, to mitigate this risk, a contingency, usually 3-5 percent of the subcontract and general conditions costs is made available for the CM's use to offset the cost of, for example, bid errors, defective work, subcontractor defaults, scheduling conflicts, delays, etc. Often, unspent savings in the contingency are shared by the CM and the owner.

Under a cost plus arrangement, the major risk factors noted above—subcontract cost, schedule and the quality of the work—are assumed by the owner. Thus, under a cost plus arrangement, the CM is reimbursed for all costs of the work and is paid a fee, generally determined as a percentage of the cost of the work. Traditionally, any savings from preconstruction budgets are not shared by the CM and the owner.

The Cost Plus Hybrid

The cost plus hybrid form handles the risk factors differently. The risk of ultimate trade cost is assumed by the owner; however, the risk of schedule delays (caused by the CM or its subcontractors) as well as the quality of the subcontractor work is assumed by the CM.

Subcontract Cost Risk. Although the CM will actively assist the owner and its design team in developing scopes of work that meet the project budget and in buying the trades, the final cost of the work (absent subcontractor defaults or those of the CM itself) falls on the owner. This is no different than in a traditional cost plus arrangement.

Schedule Risk. The project schedule, which the CM is responsible to develop in conjunction with the owner, not only is used as a management tool to achieve the owner's completion requirements but is used

KENNETH M. BLOCK *and* JOSHUA M. LEVY *are partners of Tannenbaum Helpern Syracuse & Hirschtritt.*

to establish the CM's supervisory and project management costs, commonly referred to as general conditions costs. Once the project schedule is established and approved by the owner, the CM will estimate its general conditions costs which, under a traditional cost plus arrangement, is just that: an estimate. However, under the cost plus hybrid arrangement, the CM guarantees those costs, either through a lump sum or a capped basis. If the project schedule is extended, other than for force majeure or owner delays, the CM is not entitled to any additional compensation and must absorb those costs.

Also, in the event the project is delayed as a result of the CM's mismanagement or a subcontractor's lack of diligence, the CM would be responsible to accelerate the work through overtime or additional shifts, with the cost borne by the CM.

In order to mitigate the loss a CM might suffer from delays or extended general conditions costs for which it is responsible, the owner may be willing to provide a small contingency (say 1% of the cost of the work) to cover the CM's general conditions costs overruns. There also may be a provision for the sharing of any unspent contingency. Each of these items are "deal specific" and cannot be expected as a regular practice.

Quality of the Work. Under the cost plus hybrid, the CM is

responsible for the timely performance and quality of the subcontractor's work. Thus, a default by a subcontractor is a default of the CM. The CM can protect itself against the losses it might suffer by such default—project delays and the cost to complete or correct the work of the defaulting subcontractor—by maintaining subcontractor default insurance (SDI) or requiring its subcontractors to be bonded. The owner is responsible for the cost of such SDI or bonding.

The cost plus hybrid model eliminates the "fear factor" as to ultimate subcontract cost but places the risk on the construction manager to manage the subcontractors and the project schedule.

Even with insurance or bonding, the CM might still be exposed to losses due to defaults relating to delays and defective work that do not rise to the level triggering SDI or bonds. In that event, the contingency for schedule delays discussed above might be made available for subcontractor defaults.

Balancing the Risks

Of late, owners have been questioning the efficacy of GMPs from a cost control standpoint, believing that CMs often inflate the projected subcontract costs to give themselves protection against the GMP. The cost plus hybrid model eliminates the "fear factor" as to ultimate subcontract cost but places the risk on the CM to manage the subcontractors and the project schedule. By providing SDI or bonds and a contingency for the CM's use, the risk of subcontractor delays and defaults is mitigated and should give comfort to a CM in assuming that risk.