CONSTRUCTION RISK MANAGEMENT REPORTER

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ContrACT

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3 Ways to Lose Money In The Construction Industry

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Slim profit margins are not new to the construction industry. Contractors have long been accustomed to using various tools and industry practices to protect against loss and to preserve the enviable privilege of taking on future risks that potentially lead to more slim-margin projects.

In the past, particularly those years leading into the 21st century, common sense and general good-faith efforts often seemed enough to avoid financial catastrophe. A bad experience with a difficult owner's representative might mean that a contractor avoided future work where that individual was involved. Payment disputes arising out of changed conditions might be avoided by clear communication during project meetings. At the very least, effective communication could preserve your day in court.

As we continue to bounce back from the Great Recession, it is becoming increasingly evident that the 'good ol' days, if they ever did exist, are gone and that success in the construction industry requires a new mindset. If your company still relies upon handshakes and a personal promise, there are good reasons to consider a different approach that better responds to the risks your company faces in the current marketplace. In other words, do not:

1) Bid Work Without Thorough Assessment.

Owner-contractor agreements often attempt to shift design-related risks from the owner to the contractor with terms governing issues such as 'study and compare,' site investigation, warranty, changed conditions, and waivers of certain types of damages.

In New York and most jurisdictions, contractors are entitled to rely on the plans and specifications provided to them by the owner[1] and strict adherence with those contract documents should relieve a contractor of liability if the end-product does not meet the owner's expectations.[2] However, this is not without exception. Contractors may find themselves in a predicament if there is a glaring problem with the information provided, or if compliance with the information creates an obviously dangerous condition likely to cause personal injury.[3] Contractors may also find themselves in a difficult position if their contract contains enforceable terms that prevent them from relying on the information provided by the owner during the bid phase. One example of this is as follows:

> "It is supposed that the location, size of pipes, drains, etc., are correctly shown on the contract drawings, but the commission does not so guarantee and no claim shall be made by the contractor on account of any structure being found in a position other than shown on the plans."[4]

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Scaffold Law: Recent Cases Uphold Liability Against Contractor, CM

NELL M. HURLEY

Three recent cases illustrate the continued strict enforcement of New York's "Safe Place to Work" laws, including its "Scaffold Law,"[1] following the state's high court rulings that the harm to the worker must "flow directly from the application of the force of gravity."[2] The cases also serve as reminders that supervision by the contractor and construction manager will impact liability for workers' injuries.

In the first case,[3] the injured worker was assisting the subcontractor in raising an 18-by-18-foot exterior wall during the construction of a residence. Instead of using a crane or wall jack, the crew, including the injured worker, began to raise the wall by hand, proceeding to "walk the wall up" once the edge of the wall was above their heads. At approximately a 35 degree angle from the ground, the subcontractor reversed course, telling the men to lower the wall. As the wall was lowered, it fell on the worker.

The court found that the worker established that he "suffered

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Even with more balanced contracts such as those produced by ConsensusDocs[5] or AIA,[6] contractors are expected to thoroughly examine the information available and report potential errors. These obligations should not be taken lightly.

Project estimation should be a multi-step process giving due consideration to at least the following major concerns: pricing risks, constructability risks and legal risks. The use of standard forms or tested software, combined with ritualistic checks and balances by management go a long way to protecting profit. In addition, contractors are wise to implement mechanisms that give extra attention to analyzing bid documents for faulty presumptions and gaps in logic. If the owner is not able to get what it expects as the end product, the contractor's risk of financial loss rises dramatically.

To put your company in the best position to maintain profit margins in the face of such dilemma, present formal questions to the owner before committing to a price. The goal should be to resolve ambiguity in bid documents and to firmly establish as many owner-mandated presumptions as possible. With respect to legal risks, it is important to analyze the interplay between what may occur in the field during construction and how the proposed agreement affects your ability to protect profit. For example, a hard completion deadline combined with a waiver of delay and acceleration damages presents significant risk to a contractor obligated to perform finish work.

2) Sign Contracts You Don't Understand.

The first rule of construction risk management is "R.T.F.C." - read the full contract. Like many things in life, timing is everything when it comes to this rule. Do not sign first and read later. Develop an understanding of how typical contract terms relate to the type of work your company performs, and establish guidelines for what is negotiable and what is a deal breaker. Some contractors may find it too risky to accept a waiver of consequential damages unless it is mutual. Others may be unwilling to accept terms which mandate notice periods as short as 24 hours, payment terms that open the door for significantly delayed payments, or arbitration provisions that require hearings half way across the country.

Just like buying a car, contractors should know their walk-away point before they sit down at the proverbial negotiating table. Contract terms that may be deemed "crucial" include those that govern the following: timing for payment obligations; site inspections and changed conditions; insurance requirements; schedule obligations; change order work; claims and dispute resolution; waiver of certain types of damages; imposition of liquidated damages; termination; indemnity; warranties; governing law, jurisdiction and attorneys' fees.

3) Take a 20th Century Approach to Project Management.

Regardless of your revenue size and position in the industry, risk management should play a central role in your company, compared to twenty years ago. Owners, especially public ones, continue to enter the marketplace with constrained funds and comparatively unconstrained expectations. They want more for less. Contractors see this in owner-contractor agreements that attempt to shift more risk onto contractors at a time when competition for construction work is as stiff as it has ever been. Success in the current construction marketplace increasingly requires vigilant project oversight, accurate forecasting, creative problem-solving, and painstaking attention to administrative and legal pitfalls. As the proverb counsels, 'if you want peace, prepare for war.' In the construction business, the starting point is to assign risk management responsibilities to someone in your company.

Armed with knowledge of what the contract says, contractors should implement project-specific protocols to ensure compliance with prejudicial deadlines. If an agreement obligates a contractor to give notice of a changed condition within seven days of the date that it became aware of it, the best practice would be to implement communication practices that ensure that foremen quickly communicate issues up the chain of command to those in charge of evaluating potential claim situations.

Similarly, if the agreement requires notices to be sent by certified mail to an offsite location, do not presume that emailing a notice will suffice. Keep thorough daily records. Review and comment on project meeting minutes for accuracy. Document conversations with follow-up emails. Develop procedures for dealing with text message communications. If they are permitted, make sure they are being preserved. Have owner representatives inspect as much work as possible as the project is being constructed, and if possible, obtain documented approval.

The precise risk management efforts that your company should consider will likely vary by company and by the type of work being performed. The key for every construction company is to balance the risks presented by a contract with potential profit. As the balance becomes skewed toward risk, it becomes increasingly important to proactively identify potential problems and mitigate accepted risks. E&D

1 Knipe v. R-19 Assoc., 117 AD2d 750 (3rd Dept. 1991)

2 Fruin-Colnon, 180 AD2d 222 (4th Dept, 1992)

3 *Id.*

4 Leary v. City of Watervliet, 222 NY 337, (1918)

5 See e.g. ConsensusDOCS 200, §3.3.1 (2011).

6 See e.g. AIA A201 (2007), §3.2.2.

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harm that flowed directly from the application of the force of gravity" and that the injury was the direct consequence of the subcontractor's failure to provide adequate protection against the gravity-related accident.[4] The court rejected the subcontractor's arguments that the wall's 30-degree angle made the elevation differential insignificant and that the injury was an open and obvious hazard inherent in construction work.[5] Failure to use proper equipment to raise the wall resulted in liability.

The next case involved a worker injured when a bundle of rebar that a coworker was lowering by rope fell and hit him.[6] As he tried to keep himself and the rebar from falling onto others below him, his foot hit something, which caused him to twist his back. The defendants in the case argued that the worker was the sole cause of the injuries because they resulted from his twisting, not the fall of the rebar, and because the worker agreed to use the rope to lower the rebar. Not so, says the court, because even if the injuries were caused in part by the worker's twisting, they still resulted directly from the elevation-related risks that required the worker to struggle with the rebar. As to the decision to use the rope to lower the rebar, the court found that the defendants failed to show that an appropriate safety device was available on the site or that the worker had been instructed to use it.[7] In addition, the court found that since the foreperson had assured the worker that the rope method would be "okay," the worker could not be the sole cause of the accident.[8]

In the third case,[9] the plaintiff was injured when an iron grate fell on him while he was working in an elevator shaft. The accident occurred while the grate was being set up to prepare it for welding and, the court said, was caused by the failure to adequately secure the grate so as to prevent it from falling. Again the court rejected the argument that the falling grate was a risk inherent in work at a construction site, instead finding that the grate was a part of the very work in which the worker was engaged and thus was required to be secured.[10] In addition, the court held that the construction manager could also be held liable because it had managed day-to-day activities on the site and exercised control over the coordination of the work, enabling it to avoid or correct the unsafe condition.[11]

Such cases continue to proliferate because the statutes impose strict liability, regardless of fault, except in extremely limited circumstances, such as where the worker is the sole cause of the accident. The provision of proper safety equipment and requiring its use by workers is more important than ever. For construction managers, insist on clear contract provisions which define safety obligations or specifically disclaim them. Even in the face of such contract provisions, however, construction managers risk liability whenever they maintain and exercise supervision of the work. E&D

1 New York Labor Law, §200 et. seq.

2 *Runner v. N.Y. Stock Exch., Inc.*, 13 NY3d 599 [2009]; *Wilinski v. 334 E. 92nd Hous. Dev. Fund Corp.*, 18 NY3d 1 (2011).

3 *Zarnoch v. Luckina*, 112 AD3d 1336 (4th Dept. 2013).

4 *Id.*

5 *Id.*

6 *Gove v. Pavarini McGovern, LLC*, 110 AD3d 601 (1st Dept. 2013).

7 110 AD3d at 602.

8 110 AD3d at 603.

9 *Matthews v. 400 Fifth Realty LLC*, 111AD3d 405 (1st Dept. 2013).

10 *Id.*

11 *Id.*

Spoliation: Adverse Inference Upheld for Failure to Provide E-Mails

NELL M. HURLEY

A New York federal court recently upheld an adverse inference sanction, finding that spoliation occurred by the failure to produce internal emails related to an underlying claim.[1] In *Dataflow* the Plaintiff served numerous requests for documents, including internal communications. Responses failed to include responsive emails. After depositions, where it was disclosed that internal email was routinely used to communicate about claims, the defendant reported that the emails were unavailable because of a "system change," in which emails not actively marked for preservation were deleted. The Defendant argued that the current retention policy was not in effect until after the system change occurred, and that the loss of the emails was unintentional, inadvertent or otherwise insufficient to warrant a sanction for spoliation.

The Court was not convinced. The duty to preserve arises "once a party reasonably anticipates litigation,"[2] and requires that the party suspend its routine document retention/destruction policy and put in place a litigation hold to ensure the preservation of relevant evidence. If a party's conduct is grossly negligent, reckless or intentional, sanctions can be granted without proof that destroyed items are relevant. Where there has been mere negligence, spoliation sanctions are still appropriate if there is any likelihood that the destroyed evidence would have been of the nature alleged by the party affected by its destruction such that it is relevant to that party's claim.[3] In Dataflow, the Court ruled that both standards had been met.

New York Courts routinely impose sanctions on parties that fail to preserve evidence. Nonetheless, many litigants continue to give a blind eye to preservation rules. Cases such as *Dataflow* make it clear that parties that take a lackluster approach to preservation do so at their own peril. Implementation of, and compliance with, clear document retention policies is critical for all businesses, and perhaps especially for those in the construction industry where disputes and the possibility of litigation is common. E&D

1 *Dataflow, Inc. v. Peerless Ins. Co*, No. 3:11-cv-1127 (LEK/DEP), 2014 WL 148685 (N.D.N.Y. Jan. 13, 2014).

2 *Zubulake v. UBS Warburg, LLC*, 220 F.R.D. 212 (S.D.N.Y. 2003).

3 *Residential Funding Corp. v. DeGeorge Fin. Corp.*, 306 F.3d 99 (2d Cir. 2002).

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Ernstrom & Dreste also publishes the Fidelity and Surety Reporter. If you would like to receive that publication as well, please contact Clara Onderdonk at conderdonk@ed-llp.com. Copies of ContrACT Construction Risk Management Reporter and The Fidelity and Surety Reporter can also be obtained at Ernstrom & Dreste's website (ernstromdreste.com).

FIRM NEWS

O'Gara Named Partner

Ernstrom & Dreste, LLP is proud to announce its promotion of associate Thomas O'Gara to partner in the firm effective July 1, 2014. Mr. O'Gara's practice is focused in the area of commercial litigation, with particular emphasis in the fields of construction and surety law.

E&D Presenting on Various Industry Issues

John Dreste, Kevin Peartree, and Timothy Boldt recently gave a presentation on the AIA contract documents. An upcoming presentation titled "Contracts for Every Construction Project, Every Party and the Bottom Line" will be given by Kevin Peartree, Martha Connolly, Timothy Boldt, and Thomas O'Gara.