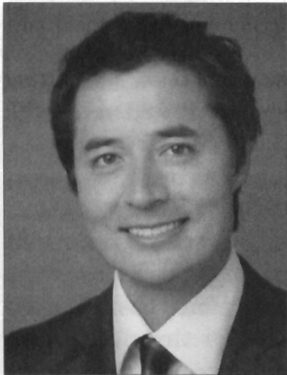
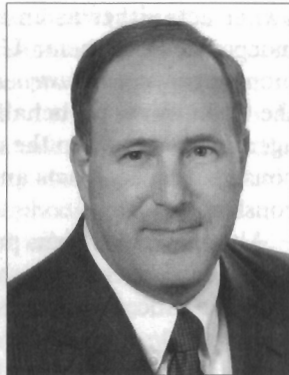


# Is the Construction Manager Holding Any of the Cards? A Critical Look at Construction Management at Risk Today

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The role of the construction manager on private and public works of improvement has evolved over recent decades. Where the construction manager was originally perceived as a luxury to many project owners, the construction manager has become a necessity as projects become more complex. Even sophisticated and experienced private and public owners are relying upon construction management firms for assistance in minimizing potential risks to their projects' viability.

Prior to the current economic downturn, construction management firms were prospering as they filled their portfolios with intricate projects. Managing risk was of the highest priority for both corporate developers and public agencies as increasingly complex projects were crippled by cost overruns, delays, and litigation. Owners relied upon construction managers to deliver a more logical approach to designing and constructing projects by providing earlier control over scope, budget, scheduling, and risk. Coinciding with the growth in the construction management industry, new approaches to project delivery systems became commonplace and have evolved to move a project from early design development to building occupancy. These alternative project delivery approaches are all essentially designed to assign risk in the design and construction process away from the owner to third parties.

As more contractors and design firms saturated the construction management market, owners had a wider selection of experience to choose from for their particular

needs. The larger numbers of available firms, coupled with the economic recession and depressed construction market, have resulted in owners insisting on shifting more and more risk associated with the design and construction of a project to construction management firms. Moreover, construction lenders are now often mandating that owners shift a significant portion of the risks associated with either cost overruns or delays to the construction manager as a part of their loan requirements.

Construction management services were traditionally performed as the owner's agent and advisor throughout the design and construction process. Now, private and public owners are more commonly seeking to retain a construction manager who not only will act as an advisor during the design process, but who also will provide a fixed-price contract to the owner to construct the project. This relatively modern form of construction management is referred to as a *construction manager at-risk*, or CMAR. In this arrangement, the owner, who has increased leverage in the current state of the economy and construction industry, gets the best of both worlds. At the same time, construction managers walk the claim and litigation gauntlet as they assume greater risk on projects.

This article examines the role of the CMAR in today's construction industry, how the CMAR is distinguished from a classic general contractor, and the various advantages of CMAR to owners. This article also will explore the evolving legal risks to which CMARs are exposed on a typical modern construction project.

## Evolution of Construction Management Over the Last Ten Years

### *Prior to and Through the Construction Boom*

There has been a marked evolution in the construction industry in the United States over the last decade. Traditionally, many owners relied on the standard design-bid-build project delivery system (D-B-B) to develop concepts and, ultimately, construct projects. D-B-B became the most popular delivery method for construction projects because it is well understood and provides specific roles for the parties involved. D-B-B also remains the most common approach for public entities that must comply with state procurement statutes. While D-B-B offers the owner a significant amount of control over the end product, D-B-B is often adversarial, time-consuming, inefficient, and costly. Moreover, owners face exposure to

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contractor claims over design and constructability issues because owners are responsible for the design.

In reaction to a proliferation of contractor claims based upon deficiencies in design documents, owners began to turn to the design-build project delivery system (D-B) wherein one entity (often a joint venture of a contractor and designer) provides both design and construction services to an owner. Whereas D-B-B often gives rise to disputes among the various project participants, D-B provides the simplicity of having one party responsible for the development of the entire project and utilizes contractor expertise and input during the design development. The D-B approach grew in popularity over the last decade because owners perceived that the D-B delivery system addressed the drawbacks and limitations of the D-B-B system, providing both time and cost savings. As construction spending more than doubled during the last decade,<sup>1</sup> the domestic D-B market saw a 110 percent increase in revenue.<sup>2</sup>

The advantages of the D-B approach, however, are offset by the owner's loss of control over the project. The D-B approach requires that less-involved owners provide sufficiently detailed concept drawings and specifications at the outset in order to control the cost, aesthetics, and quality of the completed project. For the D-B model to yield the best results for an owner, the owner must have superior confidence and trust in the D-B team, or, alternatively, the owner must secure the services of additional consultants to assist with the development of scope and

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preliminary design. Moreover, the design professional within the D-B scheme does not act independently and solely in the interests of the owner. Outside assistance is particularly important when an owner does not have an existing relationship with an experienced design firm, or when an owner does not have prior experience in constructing a similar project. As such, D-B is best suited for conventional projects with clear and concise scopes, such as office buildings or warehouses.

During the construction boom of the last decade, experienced owners took on more concurrent projects, while less-experienced owners entered the market in pursuit of striking a profit. Owners faced unprecedented levels of risk due to such factors as material cost volatility, accelerated schedules, complex funding arrangements, tighter budgets, and increasingly sophisticated projects, as a result

of integrated building systems, increasingly aggressive engineering and architectural options, and the implementation of LEED<sup>3</sup> requirements. Consequently, owners were more inclined to seek the expertise of a construction management firm to aid with the planning, design, and construction process. Owners recognized that, irrespective of the chosen project delivery method, construction managers provide invaluable expertise tailored to assist owners with managing the critical issues of risk, cost, time, scope, and quality.

Generally, the construction manager selected by the owner acts either as an agent for the owner or as an independent contractor. Under the agency scenario (commonly known as *construction manager agency* or CMA), the CMA works on behalf of the owner and acts as its agent with respect to the administration of the owner's construction contracts and the management of project construction.

Although CMA firms provided owners with increased expertise in overseeing the planning, design, and construction process, owners still encountered cost overruns and lengthy delays. The reasons for these costs and delays included poor cost estimation, price escalation, increasingly litigious conflict, or other failures in risk identification. Thus, some owners looked to a project delivery method where the construction manager aided the owner in the design process, yet later provided a fixed price proposal to the owner to construct the project. The construction manager in this independent contractor role (commonly referred to as the CMAR) is selected by means of a qualification-based process. In the mid-2000s, CMAR firms saw an 87.1 percent increase in revenues.<sup>4</sup> This increase was even more impressive considering the fact that statutory prohibitions precluded most public entities from utilizing the CMAR model.

#### *After the Economic Downturn*

As the construction industry slowed, construction owners increasingly shifted away the risk of cost overruns. As construction spending decreased in 2007 and beyond, owners that were still developing and building projects asserted their leverage in a constricted market by insisting on utilizing the D-B and CMAR approaches to limit risk. D-B and CMAR firms increased revenue domestically by 19.9 and 10.7 percent respectively, from 2007 to 2008.<sup>5</sup>

While the private construction market stalled, public works of improvement remained fairly steady. In 2009, contractors and legislators led a concerted effort to pass more than 100 pieces of legislation around the country to expand the ability of public agencies to utilize the D-B construction delivery system.<sup>6</sup> Legislative efforts have also loosened restrictions on the CMAR model for public projects in selected jurisdictions. As a result, the overall effect of the economic downturn has had less impact on the revenues for the D-B and CMAR firms, as compared with the industry-at-large. Based upon the popular perception that the CMAR model delivers projects more efficiently, and



the enactment of additional legislation to allow CMAR in the public sector, the outlook for the CMAR project delivery method is promising.

### **The CMAR Model**

#### ***CMAR Versus Traditional General Contractor***

In theory, the CMAR model appears to be nothing more than a variant of the traditional D-B-B approach. In practice, however, the CMAR delivery approach can have significant advantages in terms of cost and time over the D-B-B project delivery system. The advantages are primarily due to (1) the introduction of construction expertise early in the design process and (2) closer scrutiny of the project schedule and coordination by the CMAR during the construction phase, because the CMAR has "skin in the game." Theoretically, the CMAR is able to manage risks better than a general contractor because of its preconstruction knowledge and the relationship it establishes early on among project team members.

The dual nature of the CMAR results in a closer relationship with the owner. More so than a conventional general contractor, the CMAR is expected to have the owner's interest at heart. The industry standard form contract language reflects this closer relationship. For instance, section 1.2 of AIA Document A133-2009 (Standard Form of Agreement Between Owner and Construction Manager as Constructor) states:

The Construction Manager accepts the relationship of trust and confidence established by this Agreement and covenants with the Owner to cooperate with the Architect and exercise the Construction Manager's skill and judgment in furthering the interests of the Owner; to furnish efficient construction administration, management services and supervision; to furnish at all times an adequate supply of workers and materials; and to perform the Work in an expeditious and economical manner consistent with the Owner's interests.

Further, many legislatures and courts around the country differentiate the CMAR approach from the general contractor approach by categorizing the former as "professional services." The fact that the CMAR often carries professional liability insurance has convinced courts that it owes a duty to adhere to professional standards.<sup>7</sup> In addition, some courts construe the CMAR as the owner's agent rather than an independent contractor, which may have far-reaching implications for the owner, design professional, subcontractors, and the CMAR.<sup>8</sup>

#### ***The CMAR Agreement***

Unique to the CMAR delivery system, the contract documents will generally identify two distinct project phases: preconstruction services and construction phase services.<sup>9</sup> The CMAR approach is similar to a general contractor providing preconstruction services and furnishing a fixed

price for the construction. The CMAR provides preconstruction services to the owner during the design phase, wherein the CMAR and owner usually develop a level of trust amongst themselves. Thereafter, the CMAR essentially acts as a general contractor by providing the owner with a lump-sum or guaranteed maximum price for the construction phase services.

In the CMAR approach, there is a contract between the owner and the designer, and a separate contract between the owner and the CMAR. The selection of CMARs by owners is usually based upon submission of qualifications from the potential CMAR firms. Prior relationships with the owner, prior experience of the firms, and the expertise of the individual persons to be utilized on the project are normally the most important criteria by which a CMAR firm is selected. This qualification-based selection is different than the standard D-B-B model where construction price, along with the firm's experience, is the major factor in selecting the contractor to build the project. Because the CMAR is usually selected early in the design phase, the project has not been sufficiently defined to determine a reliable construction price. Accordingly, the CMAR usually works on a time-and-materials basis for its preconstruction services performed during the design phase. Once the project design has been sufficiently developed, the CMAR then provides a fixed price, and enters into a separate contract with the owner, for the construction phase of the project.

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Of course, the CMAR also has the ability to tailor which duties and responsibilities it will take on based upon the specifics of the agreement between it and the owner. Despite the close relationship that CMARs usually maintain with owners, market forces typically limit the extent to which the CMAR may dictate its scope and corresponding liability.

#### ***Key Benefits of Using CMAR***

Although the construction phase of the CMAR model appears to generally mirror the D-B-B project delivery system with a general contractor, this arrangement can provide several benefits for the owner. One of the key benefits is a reduced time to bid and construct the project over that normally occurring in the D-B-B approach. Because the CMAR involves key subcontractors in design

phase reviews, those entities are already familiar with the project and are able to provide bids in a shorter time. Also, because the key subcontractors are identified, less time is required to identify the potential subcontractors immediately prior to bid time. This also allows for faster turnaround time to bid and commence construction. Additionally, based upon the oversight of the design process, constructability reviews, and document reviews for consistency, more owners are willing to start the construction process prior to final completion of the design documents. The CMAR also may allow performance or

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reduced specifications to be used because the CMAR's involvement can lead to early agreement on various project features and materials. As previously noted, reducing the time for design and construction usually translates into lower costs for construction.

Because the CMAR is involved with the design phase and has performed several iterations of budgets for the design, the contingency values placed on the construction price may be lower than that which would be included by a general contractor that had spent less time in review of the plans. Moreover, because the CMAR has been involved in review of the plans for constructability and provided review to eliminate conflicts in the documents, fewer change orders are likely to be issued in the construction phase as a result of alleged design defects. Reduced contingency and fewer change orders translate to a lower cost to the owner.

#### **Design Phase Assistance**

During the design phase, the CMAR provides guidance to the owner to ensure that designs (1) are within the owner's budget, (2) are constructible, (3) have minimal coordination errors, (4) have taken advantage of value-engineering when possible, and (5) are completed on time. The CMAR usually participates in meetings between the owner and design team. In addition, the CMAR may include key subcontractors it intends to utilize on the construction phase to assist in providing design input.

The CMAR typically provides preliminary cost estimates for each round of design progress drawings. These estimates often establish the initial project budget, and later are used to confirm that the design remains within the budget. One of the key components of the CMAR's

project budget is a contingency line item to account for items that are not completely defined in the design progress drawings and specifications. As the project design develops, and the design documents more fully identify the key information such as equipment and finishes, the CMAR's contingency usually narrows. As the CMAR will be eventually negotiating a fixed-price contract with the owner for the project, it is important that the CMAR's estimates are accurate at all phases of the design process to avoid significant budget modifications or additional contingencies at the time the construction contract is negotiated. Because the CMAR's negotiated construction price is usually provided in a line-item level of detail, owners generally will not allow there to be a large contingency within the CMAR's final price.

The CMAR is usually the owner's consultant with the most experience in constructing projects. As a result, the CMAR often provides a constructability review on the design drawings to avoid significant change orders during the construction phase. The CMAR also reviews the complete design package to look for instances where the documents conflict, as the conflicts may result in cost increases and delays during the construction phase if not corrected in the design phase.

Where the owner's budget is exceeded, based upon either pricing provided during the design phase or at the time the CMAR's fixed-price contract is being negotiated, the CMAR may be tasked with providing the owner with value-engineering alternatives that bring the construction cost within the owner's budget. This value engineering effort can include working with the design team to propose alternative project configurations, suggesting alternative specifications of equipment or finishes, or proposing alternative construction sequencing or scheduling. For any of these options, the CMAR provides the owner with the revised budget assessment.

As the CMAR is most experienced in ordering equipment or other items that require a long lead time, the CMAR may assist the owner in finalizing the specifications and ordering these items on behalf of the owner during the design phase. By assisting with this activity, the CMAR can reduce the risk of delays to the completion date of the project due to these long lead-time items. Where items are ordered on behalf of the owner, they may later be incorporated into the fixed-price construction contract between the owner and the CMAR.

Lastly, the CMAR assists the owner in monitoring the submission of design documents and maintaining the overall design schedule. Delays in the completion of the design documents will push back the bidding of the project and ultimately may delay when the owner can take beneficial occupancy of the completed project. In addition, delays to the start of a construction project many times result in cost escalations for equipment, materials, and labor that translate to budget increases for the owner. Therefore, the CMAR's maintenance of the design schedule reduces the risk of budget increases due to late design completion.



### **Bid Phase**

During the construction bidding process, the CMAR assists with: (1) assembling the bid packages, (2) prequalifying bidders, (3) coordinating responses to bidders' questions, (4) evaluating bids submitted, (5) making recommendations as to which bidders should be selected, and (6) negotiating final contract terms with the selected subcontractors. In most instances, the CMAR secures bids from subcontractors who will work directly for the CMAR to perform portions of the work scope identified in the CMAR's fixed-price contract. Based upon the bid values provided by the selected subcontractors, the CMAR then finalizes its line-item costs for the fixed-price budget to be negotiated with the owner.

The CMAR is usually best suited to prequalify the potential subcontractors from whom bids will be requested. The owner also may provide its input based upon past experience with prospective bidders. As the CMAR will have to enter into subcontracts directly with the chosen bidders, and thus rely on the subcontractor's ability to perform the required scope, it is in the best interest of the CMAR to choose subcontractors with sufficient experience for the project. This process can benefit the owner as well, as subcontractors with a track record of working for the CMAR are less likely to initiate disputes on the project. Additionally, the CMAR is well suited to oversee the submission of and responses to bidders' questions. This oversight usually reduces response times and ensures complete responses to the bidders' questions.

The CMAR's industry experience, its project-specific experience in monitoring the design process, and its self-interest in having the design documents fully define the construction scope, make it uniquely suited to assemble the bid packages sent to prospective bidders. Additionally, because the CMAR has provided the preliminary budget for the project and has confirmed all line-item costs within its own fixed-price bid, the CMAR is best suited to review and evaluate the bids received from its potential subcontractors and equipment suppliers.

### **Construction Phase**

In this model, the CMAR is in direct contract with the owner for construction of the project at a fixed price. The CMAR then subcontracts directly with all of the selected subcontractors and suppliers on the project. The relationship between the owner and the CMAR, similar to that of an owner and general contractor, requires the CMAR to communicate with the design team and submit documentation to the owner for approval. Most importantly, the CMAR is responsible for defective or delayed construction, as well as noncompensable cost overruns on the project. However, some of this risk can be shifted based upon the terms of the CMAR contract, and often the CMAR contingency line item is available to the CMAR for use in satisfying unanticipated rework or scope gaps.

During the construction phase, the CMAR is responsible for project delivery and potentially provides the

following services: (1) issuing project schedules, (2) monitoring project progress, (3) managing project safety, (4) providing quality assurance and quality control for site work, (5) supervising or managing construction, (6) securing required permits, (7) providing required project close-out documentation, (8) coordinating the activities of the subcontractors, and (9) coordinating communication with the owner and the design team.

During the design and/or bid phases, the CMAR generally produces a preliminary construction schedule. During the construction phase, the CMAR is required to provide a critical path method (CPM) baseline schedule that defines all of the project tasks and meets the overall completion date of the preliminary schedule. This baseline schedule is approved by the owner prior to mobilization. The CMAR then provides project update schedules to the owner on a monthly basis for approval. The CMAR is also typically tasked with monitoring the site progress and incorporating any such progress into its schedule updates.

Because the CMAR is responsible for the entire construction project, it usually is required to provide insurance to cover the work at the project site. Thus, as part of the insurance protection provided to the owner, the CMAR provides job-site safety guidelines and monitors and enforces those guidelines with its subcontractors at the site.

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As part of its responsibility to provide a completed project that meets the requirements of the project plans and specifications, the CMAR provides quality assurance and quality control reviews of all work being performed on the project site. Although the CMAR holds the subcontractors responsible for completing their work per the contract documents, the CMAR is still responsible to the owner for the completed project. Thus, the CMAR usually provides daily or weekly reviews of the subcontractors' work to ensure their performance per the project requirements.

The CMAR also coordinates the work of its subcontractors to ensure that the individual entities are performing their work in the appropriate sequence and location, as necessary to maintain the approved project schedule. Therefore, the CMAR is required to manage the interaction of the subcontractors as necessary to maintain the project schedule.

Similar to a general contractor, the CMAR is

responsible for assembling any project correspondence from itself or its subcontractors and providing a coordinated communication to the design team members or the owner. This involves documents such as requests for information, submittals, change order requests, payment requests, and project close-out information. The CMAR is typically required to maintain copies of these communications at the site as part of the project records.

## Regulation of CMAR

### State License Laws

All states have enacted licensing statutes for architects and engineers, while most states have enacted license laws for contractors. State regulation of construction management, however, is evolving and multifaceted. As of spring 2012, only two states (Idaho and Oklahoma) had specific laws regulating "construction management" as a separate profession.<sup>10</sup> In reality, CMARs perform duties that could be construed as either architectural or engineering in nature and, in some instances, involve actions normally reserved for the contractor. Licensing requirements to perform construction management duties vary dramatically throughout the United States.<sup>11</sup> Depending on the jurisdiction and the services performed, the CMAR may have to be licensed as an architect, engineer, contractor, or some combination of these professional certifications.

To complicate the matter, many state statutes and regulations actually mention "construction management" within the definition of an *architect* or *engineer* for licensing purposes.<sup>12</sup> Therefore, simply reading the applicable statutes may not clarify the licensure requirements. However, some states provide clarifications within their architect and engineering licensure statutes. For example, one state provides that despite the fact its architectural

opinions that provide guidance as to the intent of the statutes or regulations.<sup>14</sup>

Because the CMAR performs services similar to those of a contractor in the construction phase of a project, it is likely that a construction manager must possess a contractor's license in many states in order to provide some of its construction management services. For example, New Mexico and Nevada both have contractor license statutes that define the term *contractor* to include a construction manager who performs management and counseling services on a project.<sup>15</sup> Therefore, a CMAR firm intending to provide services in the United States should investigate the actual licensure requirements in the jurisdictions where they work prior to entering into a construction management agreement. Failure to do so risks the possibility of penalties for providing services without a valid state license. This is especially critical in states such as California that prohibit an unlicensed contractor from seeking any recovery on a project, and also allow the owner to disgorge all payments made to the unlicensed contractor.<sup>16</sup>

### State Prohibitions on CMAR for Public Works

Like D-B, many state statutes prohibit CMAR for public works projects. States such as Indiana, Missouri, and South Carolina prohibit or limit construction managers from self-performing contract work. The CMAR model, however, is gaining traction for public works. In Nevada, for example, the legislature expressly authorized CMAR for public works in 2007. On July 1, 2011, Ohio passed dramatic changes to its public works procurement statute, authorizing both D-B and CMAR.<sup>17</sup>

Much like D-B, however, statutory authorization for this alternative procurement method has not been uniform. Some states, such as California and Florida, have authorized CMAR for specific agencies, while others, such as Arizona, have authorized only demonstration projects. It is imperative that the CMAR satisfy itself of the sufficiency of legal authority for CMAR for a particular public project or else face possible consequences of the contract being deemed void.

In addition, public entities must ensure compliance with its state's procurement statutes. Although construction contracts for public works are often awarded through competitive bidding, contracts for architectural, engineering, and construction management services are often exempt from competitive bidding because they are considered contracts for professional services. In some states, including California, Florida, and Kansas, there is a qualifications-based selection process that may consist of requests for qualifications and interviews with the public agencies. In other states, such as Massachusetts, Minnesota, and Texas, construction managers are still required to publicly advertise and receive bids for trade contracts and are permitted to self-perform construction through competitively bid trade contracts. Finally, in states like Nevada, the CMAR is authorized to use its own qualifications-based selection process to select trade contractors.

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license statute includes descriptions of construction management duties, the statute does not preclude contractors or builders from engaging in construction management services.<sup>13</sup> Depending on the interpretation of these statutes by courts, a construction management firm may have to be licensed specifically as an architect or engineer in various states to comply with the statutes. Unfortunately, there is a general lack of case law or attorney general



### **Self-Regulation**

Various professional organizations and associations self-regulate construction management with their respective codes of ethics, professional certifications, and accreditations of postsecondary construction education programs. For instance, the Project Management Institute (PMI) publishes a code of ethics that outlines the process for punishment for violation of its standards. PMI, in addition to the American Council for Construction Education and Associated Schools of Construction, also offers accreditation when the construction manager demonstrates appropriate education and professional experience, passes a rigorous examination, and agrees to abide by its code of conduct. The Construction Management Association of America's independent administrative body, Construction Manager Certification Institute, has a construction manager certification program that requires the construction manager to demonstrate experience or education (or both) and pass an examination.

### **Legal Issues for CMAR Entities**

As the actual responsibility and liability for CMAR entities depend specifically on the terms of their contract with the owner, the following will focus on the standard duties and obligations undertaken in typical construction project agreements. Because the CMAR often acts in a role similar to a general contractor, courts tend to treat the CMAR similarly to a contractor in determining the CMAR's liability. However, because the CMAR acts as an advisor to the owner during the design phase, and in some instances during the construction phase, courts must examine the context of the CMAR's actions in each instance in order to evaluate liability.

### **Design Phase Considerations**

Many CMAR firms treat the preconstruction phase as a zero-profit marketing tool that may lead to a negotiated agreement to manage and perform the construction phase. Although most CMAR firms have significant experience that enables them to assist design professionals with meeting budgetary requirements imposed by the owner and evaluating feasibility and constructability of the proposed design, the construction manager must be wary of stepping over the murky line of services that should (or must, per licensure laws) be performed by licensed design professionals. Of course, the key is to assist the design professional and owner without assuming design responsibility because the resulting liability exposure can far exceed any goodwill that might be earned by performing services for little or no profit. The CMAR's liability to an owner commonly manifests itself in the form of claims for professional negligence, negligent misrepresentation, and breach of fiduciary duty.

### **Fiduciary Duty**

Where a CMAR contracts to provide professional services to an owner, such as engineering or architectural services, as part of an overall CMAR agreement, the CMAR may

assume a fiduciary duty to the owner. Both the AIA and respective engineering societies contain provisions in their ethical standards whereby an entity providing services to an owner must act in the best interest of that owner, notify an owner of potential conflicts of interest, and avoid taking any action that constitutes a conflict of interest.<sup>18</sup> Thus, where a CMAR employs licensed architects or engineers who provide professional services as part of the CMAR agreement, the CMAR can take on the responsibility to meet the ethical requirements of their respective professions or risk being found in breach of fiduciary duty to

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the owner. One of the key requirements for this duty is a reasonable expectation on the part of the owner that the CMAR is acting in the owner's best interest.

However, the CMAR may take steps to avoid creating this fiduciary relationship. First, the CMAR may include terms in its contract with the owner that expressly state that the CMAR is not acting exclusively for the benefit of the owner or in a fiduciary capacity. Second, the CMAR can provide express statements in each of its communications that provide recommendations to the owner, advising the owner of any possible conflict of interest with the CMAR, and suggesting that the owner seek a third-party review of such recommendations to protect the interests of the owner. Finally, the CMAR can qualify any recommendations or valuations provided to the owner in the design phase to avoid any guarantees of performance that later can be construed against the CMAR. Examples of this last instance can be found in ConsensusDOCS 500 (Agreement and General Conditions Between Owner and Construction Manager) where the construction manager covenants merely to furnish his or her best skill and judgment in furthering the interests of the owner.

### **Failure to Identify Design Defects**

Where a CMAR's duties include providing a design review for the owner, failure to provide a complete review of the design documents can result in liability to the CMAR for future delays and costs resulting from a deficient review. For example, where a CMAR agreed to perform a design review of the drawings prior to the start of construction but failed to perform any review of the electrical system design, and the project experienced 5,555 RFIs, many of which were based upon revisions to the electrical

system, the CMAR was held partially liable for the resulting costs.<sup>19</sup> Generally, the CMAR can be held liable if it promises to perform services for the owner but fails to provide those services in accordance with the applicable professional standard of care.<sup>20</sup> It is also important for the CMAR not to engage engineers or testing agencies directly, as this may also expose the CMAR to liability for such predesign tasks as geotechnical or environmental investigations.

#### **Improper Scheduling and Coordination**

Regardless of whether the CMAR contracts directly with subcontractors, the CMAR can be held liable for delays to subcontractors due to negligent preparation or management of the project schedule. Many jurisdictions allow for liability to be assessed against a CMAR (or contractor) for damages to a subcontractor based upon the duty owed by the CMAR to the owner to provide scheduling services on a project.<sup>21</sup> Thus, a CMAR could be liable based upon a deficient schedule that causes delay to subcontractors. In addition, where a CMAR fails to adequately coordinate the work of subcontractors by failing to notify each subcontractor as to when and where it is expected to perform its work to meet the overall project schedule, a CMAR can be liable for delay costs based upon its "hindrance" of the subcontractors' performance.<sup>22</sup>

However, a CMAR can limit or avoid its liability regarding scheduling deficiencies via express language in

### **Liability of CMARs to third parties results mostly in the context of project safety oversight.**

its contract. Where the CMAR expressly states in its contract with the subcontractor (or owner) that the CMAR is not liable for any direct or indirect costs attributable to delay, and that the sole and exclusive remedy for the subcontractors is an extension of the time of performance, the CMAR may avoid liability for cost increases for scheduling-related claims.<sup>23</sup>

#### **Budget Overruns**

As noted, the CMAR may provide preliminary budgets during the design phase, also known as *cost models*, as well as final budgets leading up to the fixed-price contract for construction. It is important that the CMAR provide sufficient contingency values in the preliminary budgets provided to the owner, where uncertainty exists due to the incomplete design elements. Otherwise, as the design evolves in the design phase, the owner's budget

will increase each time the project is budgeted. A prudent CMAR will account for this and reduce the project contingency as the design evolves, with the contingency values then moving into specific project budget line items.

Where the CMAR provides the owner with a budget update that increases the cost estimate for the project beyond the owner's available budget, the owner may look to the CMAR to assist in either providing value engineering suggestions or revising the overall design to allow the budget to be maintained. This is especially the case if there are no major design concept changes between the two versions of the design documents. Should the CMAR not provide design services, the owner may look to the CMAR to pay for some or all of the design consultant's costs to resolve this budget issue. These types of budget issues can result in the owner dismissing the CMAR from the project, and eventually litigation between the parties.

Like a contractor, the CMAR also may be responsible for increases in the budget after the fixed-price contract is executed. In order to obtain additional funds in excess of the fixed-price contract, the CMAR will have to show that there were deficiencies in the design documents, there were unforeseen job-site conditions, or the owner is responsible for the additional project costs. However, unlike a general contractor, the CMAR may have to justify why it did not identify the design defects during its design phase review of the design documents.

The CMAR also has the option of limiting its liability based upon the express terms of its contract with the owner. One method to assist CMARs in dealing with a fixed-price budget is to include qualifications to the pricing due to any uncertainties at bid time. If the CMAR can point to areas of the design that are not sufficiently detailed, it can provide contingency line items to cover potential cost increases, or it can provide a "budget" for an individual line item that is subject to change at a later date once the item is completely designed. The CMAR will usually be limited in its dealing with this type of budget flexibility based upon the implied covenant of good faith and fair dealing.<sup>24</sup> In addition, depending on the relationship between the owner and the CMAR, the owner could further be protected from self-dealing by the CMAR based upon principles of fiduciary responsibility.<sup>25</sup>

#### **Subcontractor Defaults**

Similar to a general contractor, the CMAR usually contracts with the owner to provide the construction of the completed project. Thus, where a subcontractor defaults in its performance, the CMAR would be required to complete the work of the defaulting subcontractor without receiving any additional compensation. However, where the CMAR expressly limits its liability in the contract with the owner, the CMAR may not be liable where a subcontractor defaults on the project. A court held that a CMAR did not assume complete liability for its subcontractor's failure to perform where the CMAR expressly limited its liability to its construction management fee.<sup>26</sup> Thus, when



the subcontractor walked off the job, the CMAR was not liable for the total cost to finish the work.<sup>27</sup>

### **Payment to Subcontractors**

CMARs, similar to general contractors, have attempted to limit their liability as far as payment to subcontractors where owners have failed to pay the CMAR. These limitations have come in the form of “pay-when-paid” and “pay-if-paid” clauses. Most states bar the pay-if-paid clause as being against public policy, as it would often preclude the subcontractor from ever having a cause of action against the CMAR with which it entered into a contract.<sup>28</sup> In addition, many states either bar pay-when-paid clauses or at least require that a definite and reasonable time frame be specified before the subcontractor can assert its claims against the owner.<sup>29</sup> The reasoning behind this bar centers on the states’ mechanics lien statutes, where an indefinite hold on a subcontractor’s ability to enforce a mechanics lien would unduly limit that subcontractor’s statutory protections. However, some states will still enforce the pay-if-paid clauses but require that the contract clearly express the understanding that the subcontractor will bear the burden of nonpayment by the owner to the general contractor or CMAR.<sup>30</sup>

In addition, courts also have held that if the CMAR is able to shield itself from the requirement to pay the subcontractor, based purely on the theory that the owner failed to pay the CMAR, the promise by the CMAR to the subcontractor to provide payment for the services rendered by the subcontractor would be illusory.<sup>31</sup> Therefore, a CMAR has a payment obligation to the subcontractors, irrespective of whether the CMAR has received payment from the owner.<sup>32</sup>

In at least one instance, a court has ruled that there is a distinction between a general contractor and a construction manager where the court indicated that the CMAR was not automatically liable for payments to the subcontractor. Where the owner entered into an agreement with the CMAR and the CMAR was specifically identified as a construction manager, the court held that based upon the title “construction manager” used in the operative contracts, the subcontractor was not entitled to a judgment as a matter of law that the CMAR was liable for payment to the subcontractor.<sup>33</sup> As a result, the subcontractor was required to prove the liability of the CMAR to make payments to the subcontractor, based upon the specific contract terms and other facts in the matter.

### **Monitoring Safety at the Project Site**

Liability of CMARs to third parties occurs mostly in the context of project safety oversight. Whether the CMAR assumes the liability for safety issues centers around the issue of control of the site or the actions of the subcontractors. Where the CMAR assumes the duty to oversee the construction activities, including the authority to control activities at the worksite and to stop any unsafe work practice, the CMAR can become liable to employees of

subcontractors injured at the site.<sup>34</sup>

For example, where a CMAR (1) had a duty under its contract to enforce compliance by the individual subcontractors with the applicable safety regulations and (2) maintained the authority to require subcontractors to correct unsafe conditions, the CMAR became responsible for the safety of the workers at the construction site.<sup>35</sup> Where a CMAR assumed responsibility for contractual, statutory, and regulatory compliance by all subcontractors involved on the project, the court deemed the CMAR responsible for coordinating and supervising the subcontractors and for monitoring the work of the subcontractors to protect the subcontractors’ employees.<sup>36</sup> However, in some jurisdictions, such as California, employees of a subcontractor are generally barred from bringing negligence actions against the CMAR (or contractor) and instead must seek recovery from their direct employer through workers’ compensation statutes.<sup>37</sup>

### **Additional Tips for CMARs**

Despite all of the potential risks for a construction manager on any project, the construction manager may shield itself from a significant portion of those risks by taking proactive steps. Some of the most important specific risk-limiting considerations by construction managers have been discussed above, but more general measures are outlined below.

#### **Selecting the Right Opportunities**

Like any other contractual relationship, the first and best means for a construction manager to avoid risk is to do business with the right owners. Owners with a prior relationship to the construction manager, in which the construction manager has developed a good working relationship, should be less likely to initiate litigation against the construction manager. In addition, construction managers should try to contract with owners that have a reputation for resolving their issues with contract partners, as opposed to resorting to litigation in most instances. Thus, construction managers can reduce the amount of disputes and litigation they are involved in by merely choosing to enter contracts with preferred owners.

#### **Ensure Precise Scope Descriptions**

On any given construction project, defining a specific and detailed scope of the work reduces the chance of a dispute between the owner and the construction manager. In addition, an imprecise scope description can result in the construction manager providing additional management services not contemplated or additional construction scope not budgeted. These added management or construction costs will then reduce or eliminate altogether a construction management firm’s profitability on a project. The CMAR must exclude responsibility for design and expressly defer to the architect for constructability and value-engineering. A bright-line demarcation of ultimate responsibility for such tasks during the design phase is always appropriate.

### ***Contractual Provisions Available to Reduce Risks***

Construction managers also may limit their risk exposure by tailoring contractual provisions in the contract with the owner. For example, the CMAR should include language in its contract with the owner that specifically states the CMAR is not acting in the capacity of the owner's agent. Where the CMAR merely acts as an advisor to the owner, rather than the "agent" of the owner, the CMAR can shield itself from liability to third parties based upon many issues that the owner likely controls.

The CMAR also should consider the traditional waiver of consequential damages and limitation of liability provisions. In addition, indemnity provisions should be limited to those covered by the CMAR firm's professional and commercial general liability carrier. The CMAR also should explore the possibility of being added as an additional insured to the builder's risk policy, as well as a waiver of subrogation because the CMAR is often the source of many builder risk losses. If possible, the CMAR should ensure owner responsibility for the deductible and any damages in excess of the procured builder's risk policy.

### ***Be Careful in Providing Budgets and Contingencies***

As previously discussed, it is critical that all preliminary budgets identify as many of the key components as possible in order to estimate costs and provide varied contingency line items that account for the uncertainty in the design over the various stages of the design process. Ensuring that the owner is expecting the proper budget through all of the design phase will reduce the chance of disputes and major redesigns of the project. If possible, the construction manager should identify any assumptions that it makes in deriving its budget values. This allows a discussion between the owner, the construction manager, and the design team to verify that all parties are of the same understanding as to the direction and makeup of the design.

In instances where the construction manager is

providing a fixed price to construct the project, the construction manager must identify any and all ambiguities or uncertainties at the time the price is negotiated with the owner in order to lower its financial risk for cost overruns. Construction managers also must be diligent in requiring design modifications to the construction documents to reflect the assumptions included in the final budgets. In addition, the construction manager and the owner can find ways to share the risk for any uncertainty at the bid time. An example of this includes where the owner and the construction manager share in the use of the contingency fund that the owner normally holds. This method also can be coupled with incentives for the construction manager, whereby the construction manager is paid a percentage of the owners' unused contingency value.

### ***Statutory Protections***

In private works of improvement, contractors (in most states) have available statutory protections under mechanics lien statutes. Construction managers, where operating as a contractor, will likewise have the same statutory protections. These statutes allow a contractor to place a lien on the owner's property in the instance of nonpayment for providing labor or material to improve the property.<sup>38</sup> This statutory protection minimizes the risk of construction managers not being paid in connection with construction projects. In addition, in the private sector, owners in some instances provide payment bonds to the construction manager to ensure payment on the project. Thus, if payment is not made pursuant to the construction contract, the construction manager can potentially recover from the payment bond surety company.<sup>39</sup>

It also should be noted that, in California, an additional statutory protection is provided to contractors and CMARs in the private works context. Private owners are required to provide project security in the form of a payment bond, a letter of credit, or an escrow account for 25 percent of the construction contract amount. This project security is required for all projects over \$5,000,000 for owners who own the entire property and for all projects over \$1,000,000 for owners who own less than the entire property involved.<sup>40</sup> CMARs should keep an eye out for these types of statutes in their jurisdictions, as many jurisdictions take the lead from California in enacting statutory protections.

### ***Market Forces Limit Construction Managers' Options***

In a tight construction market, construction managers have limited control over the parties with whom they contract and the terms within those contracts. However, a construction management firm must produce sufficient business to maintain its workforce. Because the construction industry has a shortage of experienced construction managers, it is especially important for construction management firms to hold onto the key management personnel they employ. Therefore, in the current business environment, most construction management firms must balance

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the work volume needed to keep their key personnel against the added risks they are assuming.

### Conclusions

The design and construction process for any modern construction project exposes private and public owners to myriad potential pitfalls and risks. Owners enlist construction management firms to guide them through the complexities of a typical construction project. More and more, owners look to the CMAR model to maximize risk-shifting.

CMAR firms must understand the nuances of the construction management contracts into which they enter. As set forth above, there are numerous financial and legal risks associated with design oversight, bid assistance, and construction of a project. It is important that construction management firms take proactive steps to limit their risks, share and shift risks with the owner and subcontractors where possible, and use their professional skill to manage any unavoidable risks. Managing such risks can be as fundamental as knowing and selecting the owners with whom they agree to enter into contracts. Moreover, successfully managing risk may require more thorough analysis, including qualifying any recommendation or projection provided to owners, as well as ensuring that the project scope is sufficiently precise, in order to avoid inadvertently including items not accounted for in the construction manager's budget.

Given the recent economic and construction industry climate, construction managers have shouldered a greater portion of the overall risk of construction projects. As a result of this evolution, it would appear that the owner, and not the construction manager, is now "holding all the cards" in the owner/construction manager relationship. Therefore, it is now more important than ever for construction managers to fully understand and manage risks of the modern-day construction project. ☐

### Endnotes

1. Gary J. Tulacz, *The Top 100 Design-Builders, Construction Management-At-Risk and Design-Build Firms*, ENG'G NEWS REC., June 7, 2010, at 26.

2. *Id.* at 25 (stating that the 2004 domestic design-build revenue for the top 100 firms was \$30.56 billion, compared to the 2008 revenue of \$64.42 billion).

3. Leadership in Energy and Environmental Design (LEED) was developed by the U.S. Green Building Council to provide rating certifications for buildings based upon energy efficiency.

4. Tulacz, *supra* note 1 (stating that the 2004 CMAR revenue for the top 100 firms was \$48.53 billion, compared to the 2008 revenue of \$87.74 billion).

5. *Id.* at 24 (stating that the 2007 design-build revenue for the top 100 firms was \$53.7 billion, compared to the 2008 revenue of \$64.4 billion).

6. *Id.* at 26.

7. 1325 N. Van Buren LLC v. T-3 Grp., Ltd., 701 N.W.2d 13 (Minn. Ct. App. 2005).

8. *See, e.g.*, Aladdin Constr. Co., Inc. v. John Hancock Life Ins. Co., 914 So. 2d 169 (Miss. 2005) (subcontractors may recover against owner despite lack of privity as construction manager may be independent contractor or agent depending on facts);

*see also* R&A Constr. Corp. v. Queens Boulevard Extended Care, 290 A.D.2d 548 (N.Y. 2002) (construction manager acting as agent rather than independent contractor, so as to preclude dismissal of subcontractor's claim for breach of contract against owner not in privity).

9. For an example of a two-phase CMAR agreement, *see*, for example, AIA Document A133-2009 or AIA Document A134-2009. *But see* CMAA Document CMAR-1 (2004 ed.) (dividing CMAR's services into five phases: predesign, design, procurement, construction, and postconstruction).

10. IDAHO CODE ANN. § 54-4501 et seq. (2012); OKLA. ADMIN. CODE § 580:20-17-1 et seq. (2012).

11. CONSTR. MGMT. ASS'N OF AM., STATE BY STATE REVIEW OF LICENSING REQUIREMENTS AFFECTING CONSTRUCTION MANAGERS 1 (2011 ed.) (1994) [hereinafter CMAA].

12. *See, e.g.*, N.Y. EDUC. LAW § 7301 (McKinney 2012).

13. *Id.* § 7306.

14. CMAA, *supra* note 11, at 2.

15. *Id.*; *but see* Kourafas v. Basic Good Flavors, Inc., 120 Nev. 195 (2004) (architect's lack of contractor's license did not preclude recovery for construction management services, even though definition of "contractor" expressly includes construction management, yet expressly excludes architects).

16. CAL. BUS. & PROF. CODE § 7031 (West 2012).

17. OHIO ADMIN. CODE § 153:1-1-01 et seq. (2012).

18. Cal. Bd. for Prof'l Eng'rs, Land Surveyors, & Geologists, CAL. CODE OF CONDUCT FOR PROF'L ENG'G R. 475 (2012).

19. *In re Elec. Mach. Enters., Inc.*, 416 B.R. 801, 833-34 (Bankr. M.D. Fla. 2009).

20. Fifth Day, LLC v. Bolotin, 172 Cal. App. 4th 939, 957-58 (2009) (construction manager acting in the capacity of an engineer, architect, or contractor must be licensed to perform those duties).

21. *State v. Malvaney*, 221 Miss. 190, 210 (1954).

22. Johnson Real Estate Inv., LLC v. Aqua Indus., Inc., 282 Ga. App. 638, 641 (2006).

23. Everyman's Elec. Co., Inc. v. Evan Johnson & Sons Constr., Inc., 955 So. 2d 979, 982 (Miss. 2007).

24. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement").

25. RESTATEMENT (THIRD) OF AGENCY §§ 8.01-11 (2006).

26. Ariz. Dep't of Revenue v. Ormond Builders, Inc., 216 Ariz. 379, 388 (2007).

27. *Id.*

28. Wm. R. Clarke Corp. v. Safeco Ins. Co., 15 Cal. 4th 882, 893 (1997).

29. W.-Fair Elec. Contractors v. Aetna Cas. & Sur. Co., 87 N.Y.2d 148, 158 (1995).

30. Envtl., Safety & Health, Inc. v. Integrated Pro Servs., LLC, 2011 WL 5412807, slip op. (W.D. Okla. Nov. 8, 2011).

31. Blandford Land Clearing Corp. v. Nat'l Union Fire Ins. Co., 260 A.D.2d 86, 94 (N.Y. 1999).

32. *W.-Fair Elec. Contractors*, 87 N.Y.2d 148.

33. R&A Constr. Corp. v. Queens Boulevard Extended Care, 290 A.D.2d 548, 549 (N.Y. 2002).

34. Pino v. Irvington Union Free Sch. Dist., 43 A.D.3d 1130, 1131 (N.Y. 2007).

35. Walls v. Turner Constr. Co., 4 N.Y.3d 861, 864 (2005) (holding, in a 4-to-3 decision, that the construction manager was "agent of owner" for purposes of New York's Scaffold Law (§ 240(1)).

36. *Id.*

37. Toland v. Sunland Housing Group, Inc., 18 Cal. 4th 253, 267 (1998).

38. *See, e.g.*, CAL. CIV. CODE § 8400 (formerly § 3110; West 2012).

39. *See, e.g., id.* § 3242.

40. *Id.* § 8700 (formerly § 3110.5).