2016 | VOLUME 2

Construction In Brief

A quarterly publication brought to you by COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

A Construction Manager as a Fiduciary in New York? Maybe

By Carol A. Sigmond and Gary J. Repke, Jr.

In the words of iconic singer-songwriter Bob Dylan, "the times they are a-changin'." A new case in New York may alter the legal relationship between owners and construction managers in the State. Traditionally, courts have viewed an owner and a construction manager as business partners, and their contract as an arms-length transaction between equally sophisticated parties. Indeed, the New York courts have firmly held that an owner cannot maintain an independent claim against a construction manager for breach of fiduciary duty, which alleges a violation of the duty of the utmost trust imposed on persons such as trustees, corporate officers, attorneys and estate executors. Courts routinely hold that such a claim is merely duplicative of a breach of contract claim because the relationship between an owner and a construction manager is contractually defined. Nevertheless, the U.S. District Court for the Eastern District of New York recently questioned this principle in *United States v. Tishman Construction Corporation* and suggested that construction managers may be headed for fiduciary status and potential tort liability.

On many construction projects today, both public and private, the owner of the subject property retains a construction management firm whose primary responsibility is to ensure that the contractors complete the work timely and in accordance with the architect's and engineer's drawings, specifications, and all local building codes. In addition, construction managers are often responsible for hiring and/or firing certain tradesmen, laborers and foremen.

Under New York law, a fiduciary relationship is always fact-specific. It is grounded in a higher level of trust than normally present in the marketplace between persons involved in arms-length business transactions. As such, where parties have entered into a contract, courts look to their agreement to determine the scope of the parties' relationship according to the contractual provisions establishing the parties' interdependency. If the parties do not expressly and unequivocally create their own relationship of higher trust, courts in New York traditionally refuse to elevate them to a higher realm of relationship or impose a stricter duty upon them.

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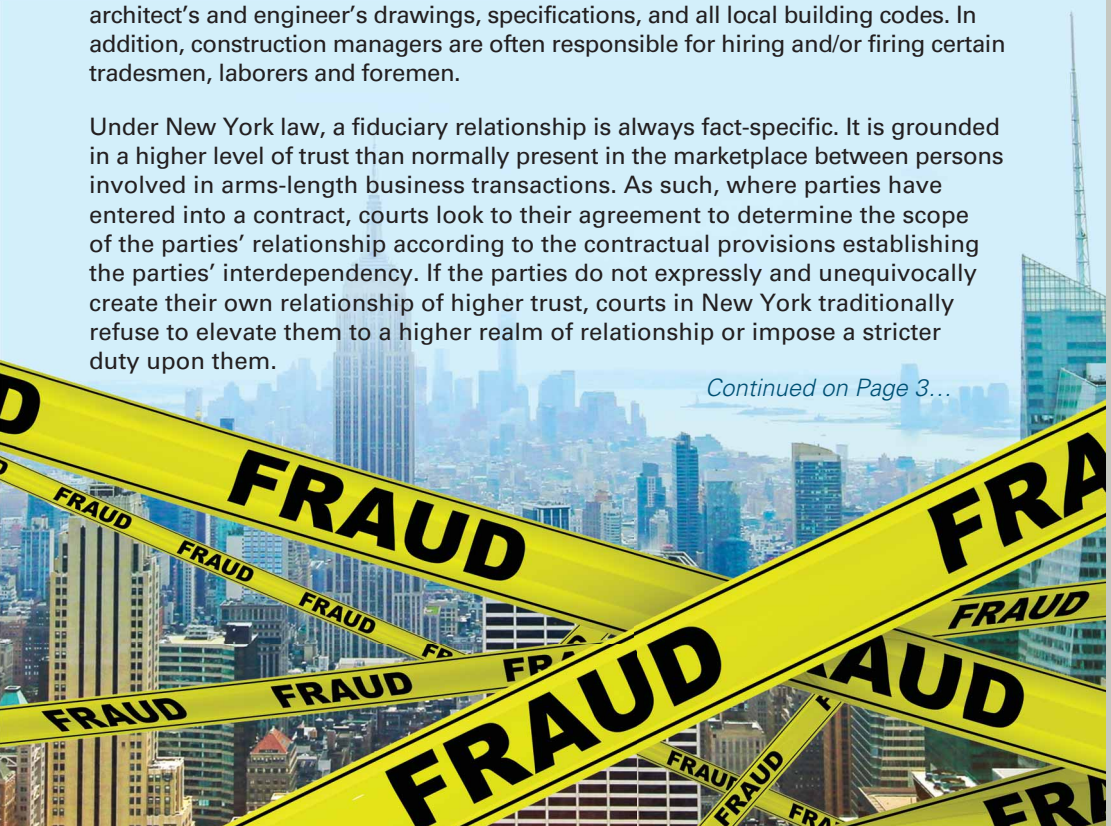

IN THIS ISSUE

Contributors:

What's New

Brief Note:

Greetings from the Editorial Team at Construction In Brief! We are excited about the Firm's office expansion in Kentucky and our new Managing Partner in the Pittsburgh office! Have you given any thought to creating a trust to preserve assets for the next generation? You will get a valuable overview of options in this issue. We are also covering recent changes in construction worker safety codes in Philadelphia and important developments to keep in mind for construction managers in New York.

Happy Summer!

Ashling
Co-Editor-in-Chief

Jennifer
Co-Editor-in-Chief

Allie
Associate Editor

By Kerstin Isaacs

Pittsburgh Managing Partner

Lisa Wampler has been named Managing Partner of the Pittsburgh Office. Lisa is the first female managing partner in the Firm's history. She joined Cohen Seglias in 2003 and has since developed an active and diverse construction litigation practice. Lisa also serves as the Chair of the Firm's Women's Initiative.

New Face

Please join us in welcoming **Matthew Skaroff**, who joins the Construction Group as an Associate in the Philadelphia office. Matt has gained litigation experience in both state and federal court since graduating from Villanova University School of Law last year. While in law school, Matt worked as an extern in the United States District Court for the District of Delaware for the Honorable Mary Pat Thynge and served as Articles Editor for the *Villanova Law Review*.

New Office Location

We are pleased to announce the opening of our office in Louisville! This new location will help us better serve our clients in this area. We will keep you updated on events and developments in Kentucky in coming issues.

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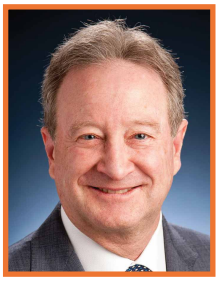
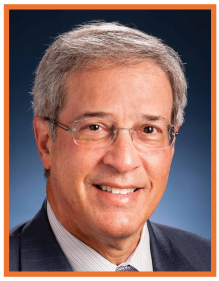
Cohen Seglias' Construction and Labor and Employment Groups Recognized by Chambers USA



Roy Cohen

Ed Seglias

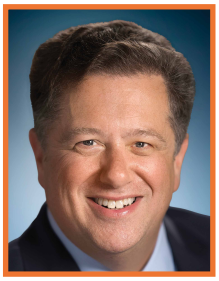


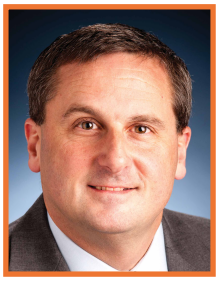
Marc Furman

The Firm was once again recognized by Chambers USA as a leader in Construction Law and Labor and Employment Law, highlighting in particular **Roy Cohen**, **Ed Seglias** and **Marc Furman**. We'd like to send a special thank you to our clients, as Chambers' researchers rely heavily on your feedback. We couldn't have done it without you!

New Practice and Blog

Paul Thaler and **Chris Carusone** are heading up our new Internal Investigations Practice, representing institutions and individuals focusing on workplace investigations, scientific and research misconduct, and Title IX investigations. Look out for the Internal Investigations blog launching soon!





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A Construction Manager as a Fiduciary in New York?

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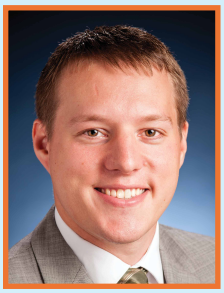
By Carol A. Sigmond and Gary J. Repke, Jr.



Enter Tishman. On December 10, 2015, the U.S. Attorney's Office for the Eastern District of New York filed criminal fraud charges in federal court against Tishman Construction Corporation, one of the largest construction companies in New York City. Over a ten-year period, Tishman provided construction management services on several significant projects throughout New York. Tishman was largely responsible for supervising the work done by the subcontractors or trade contractors, in addition to supplying workers from the Mason Tenders' District Council of Greater New York.

The U.S. Attorney's Office alleged that Tishman engaged in a fraudulent scheme by overbilling clients, including government contracting and funding agencies, for hours that were not worked by the labor foremen on each project. Specifically, Tishman drafted and submitted time sheets to its clients, hours of overtime per day whether worked or not, for certain senior labor foremen; and allowing other labor foremen to take paid sick time, major holidays, and one or two weeks of vacation per year in violation of their collective bargaining agreements. Tishman entered into a deferred prosecution agreement with the U.S. Attorney's Office, agreeing to pay more than $20 million in restitution and penalties to its clients and the federal government.

The significance of the Tishman case is best recognized in conjunction with the current trend in New York to root out fraud in the construction industry. In fact, Tishman marks the third instance of construction management fraud in the last several years. In May 2015, another large construction company entered into a non-prosecution agreement and agreed to pay more than $7 million in restitution and penalties for engaging in an eight-year fraudulent overbilling scheme. Similarly, an experienced construction management firm that was charged in April 2012 with defrauding its clients entered into a deferred prosecution agreement, and paid $56 million in restitution and penalties for engaging in a ten-year overbilling scheme. In 2010, a Manhattan construction company was indicted in State court on charges connected to an alleged scheme to inflate construction costs for interior building projects across the Tri-State area by submitting false invoices from subcontractors to developers of various building projects, and collecting the extra money through kickbacks from those subcontractors. The construction management company and three of its officers pleaded guilty to grand larceny charges and agreed to pay over $2 million in restitution. These criminal cases are notable because, as previously stated, New York law clearly provides that such business transactions should give rise to no more duties than that required by the contract. Although these cases involve criminal fraud, the jump by owners to civil fraud—a tort—is not long.

Given this recent trend, construction management firms may be held to a standard above and beyond mere contractual obligations. Other jurisdictions grappling with this issue have traditionally swayed in favor of non-recognition with respect to fiduciary relationships between owners and construction managers. In *Avon Bros., Inc. v. Tom Martin Construction Company, Inc.*, the New Jersey Appellate Division found that a fiduciary relationship did not exist irrespective of an express provision in the contract stating that "the contractor accepts the relationship of trust and confidence" with the owner. Similarly, in *Construction Systems, Inc. v. Garlikov & Associates, Inc.*, the Ohio Court of Appeals found that absent affirmative decision-making power or authority binding on an owner, the very essence of a principal-agent relationship, a construction manager does not owe the owner a fiduciary obligation.

To be clear, Tishman's responsibility as a construction manager was to contract certain labor foremen and to supervise the work performed by subcontractors onsite. Indeed, the terms of the construction management contract between Tishman and its clients specifically required that Tishman bill clients for work actually performed. In theory, Tishman's overbilling scheme gives rise to a breach of contract claim, nothing more. Tishman was not vested with the authority to approve additional subcontract work or otherwise change the project's design such that its actions would bind the owner to those decisions. Nevertheless, New York courts are carving out exceptions to this rule by indicting construction managers for criminal fraud.

As suggested above, the million-dollar question remains: when is a breach of fiduciary claim not duplicative of a breach of contract? The answer appears to be when a construction manager engages in fraudulent practices. While the attractiveness of a breach of fiduciary claim to a disgruntled owner is readily apparent given the availability of punitive damages, a remedy not available in a breach of contract case, courts have historically and consistently denied owners such relief. If New York's trend continues, however, the transition from criminal fraud to civil liability, and consequently breach of fiduciary duty, is inevitable. For now, construction managers should be wary of Tishman and its implications on the construction industry in New York.

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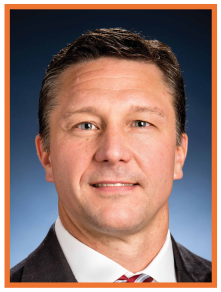
The Small Business Administration Could Bring About Substantial Changes to Mentor-Protégé Programs in the Coming Year

By Edward T. DeLisle, Maria L. Panichelli and Jacqueline J. Ryan



Last year, the Small Business Administration ("SBA") issued proposed rules that will likely result in major regulatory changes. One of the most important changes relates to the SBA mentor-protégé program and has the potential to substantially alter the landscape of that program, as well as small business contracting generally.

By way of background, the federal government currently attempts to steer a percentage of government contracts to small businesses by "setting aside" certain contracts exclusively for those businesses. As part of this effort, certain contracts are set aside for particular types of small businesses, namely those participating in the SBA's and Department of Veterans Affairs' ("VA") small business programs. These include the SBA's 8(a) program (for small, disadvantaged businesses), the SBA's HUBZone program (for small businesses located in historically under-utilized business zones), the SBA's SDVOSB program (for service-disabled veteran-owned small businesses), the SBA's WOSB/EDWOSBs program (for woman-owned/economically disadvantaged woman-owned small businesses), and, finally, the VA's VOSB/SDVOSB program (for veteran-owned/service-disabled veteran owned small businesses). Once a business is a qualified participant in one of the above programs, it is eligible for set-aside contracts designated for the applicable type of business.

However, small businesses can sometimes lose their small business status if they are found to be "affiliated" with other businesses, rendering them ineligible for set-aside contracts. A finding of affiliation can be based on a variety of factors but, generally speaking, any close working relationship between two companies poses an affiliation risk. As a rule, joint venture partners are presumed to be affiliated. This affiliation issue often discourages small businesses from working with other businesses, especially large businesses. Government mentor-protégé programs offer a potential solution to that issue.

The purpose of government sponsored mentor-protégé ("MP") programs is to partner established (and often large) business "mentors" with small business "protégés." Through these MP programs, mentors provide both business and technical assistance to their protégés, increasing the small business's ability to win federal contracts. One additional benefit, currently applicable to the 8(a) MP program only, is that joint venture partners in approved MP relationships are generally excluded from any "affiliation" analysis. In other words, large business "mentors" can assist 8(a) "protégés" and form joint ventures with those protégés, without worrying that the two businesses will be found "affiliated," or that the protégé will lose its 8(a) status or eligibility.

In February 2015, the SBA issued a proposed rule aimed at establishing one universal MP program open to all types of SBA small businesses. As explained above, while joint venture partners are presumed to be affiliated as a general rule, joint ventures formed between an 8(a) protégé and its approved mentor are an exception to that rule. In the proposed universal MP program, this exception would be expanded to cover all SBA approved MP joint ventures. This means that HUBZones, SDVOSBs and WOSB/EDWOSBs—not just 8(a) businesses—could form affiliation-proof joint ventures with approved mentors. As in the current 8(a) program, those joint ventures would then be eligible for any set-aside for which the protégé was eligible.

Needless to say, this rule could mean big changes for construction companies, both large and small. Small businesses, supported by a mentor, will be able to compete for larger contracts than they might otherwise not have been capable of winning. Larger firms, by partnering with a small business protégé, will get access to set-aside contracts for which they otherwise would be ineligible.

The SBA estimates that if the proposed rule becomes final, approximately 2,000 small business companies who do not currently qualify would likely become active in the universal mentor-protégé program. The SBA also projects

that this increased participation could result in protégé firms obtaining as much as $2 billion dollars per year in federal contracts through the program.

All of this is certainly good news. The most common question we get from our clients is "When will the universal mentor protégé program go into effect?" The answer is (hopefully) soon! In October 2015, individuals from the SBA testified before Congress, stating that the agency had organized a MP Program Expansion Project Team to oversee the implementation of the new program, and that the final rule would be issued in the first quarter of fiscal year 2016. In March, an SBA representative clarified that the final rule should be issued this summer, and that implementation is set to begin in the fall.

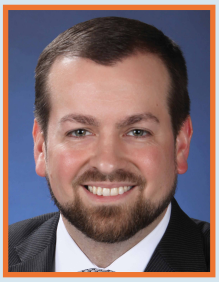
With this program set to begin within a few months, large businesses should consider making strategic alliances with small businesses as soon as possible. Of course, in order for small businesses to take full advantage of these potential opportunities, they should seek out strategic partners as well. Firms, both large and small, must be prepared for what could be a major shift in contracting practices. All businesses must adapt to become more competitive after the SBA finalizes its proposed rule in the coming year. We will most definitely keep our eyes on this one.

Ed is a Partner and Co-Chair of the Federal Contracting Practice Group, and Maria and Jacqueline are Associates, both practicing in the Federal Contracting Practice Group. They can be reached at (215) 564-1700, edelisle@cohenseglias.com, mpanichelli@cohenseglias.com or jryan@cohenseglias.com.

***Disclosure:** Edward T. DeLisle is a member of the Section of Public Contract Law of the American Bar Association and, as such, participated in drafting a Comment on the Proposed Rule: Small Business Government Contracting and National Defense Authorization Act of 2013 Amendments.*

Enforcement of New Construction Worker Safety Codes Begins in Philadelphia

By Jonathan A. Cass and James P. McGraw



The City of Philadelphia has issued new code requirements for construction worker safety training. The new rules went into effect on October 1, 2015 and the Department of Licenses and Inspections ("L&I") began strict enforcement on April 1, 2016.

Under the new regulations, all contractors and employees (including subcontractors) performing construction or demolition work in the City of Philadelphia for which permits have been issued are now required to complete OSHA 10 safety training, or an approved equivalent. This requirement applies to all trades, as well as state-registered home improvement contractors. Workers are required to carry written proof establishing that they have completed an OSHA 10 training course while on the job site, and their employers must also maintain on-site proof of completion for each worker. This information must be furnished to L&I upon request. The OSHA 10 training is only required to be completed once and does not expire.

Additionally, all contractors licensed under Section 9-1004 of the Philadelphia Code must employ at least one supervisory employee who has completed OSHA 30 safety training, or an approved equivalent, within the past 5 years. Construction or demolition of major buildings requires continuous oversight by a site safety manager who has completed an OSHA 30 course. The designated site safety manager must carry an identification card or certificate of completion issued by the provider of the OSHA 30 training course.

The identification of an employee with OSHA 30 training and written proof of completion were required for new contractor license applications made on or after October 1, 2015, and will be required to be submitted with applications for the renewal of contractor licenses which expired on or after March 31, 2016. Licensed plumbing, electrical, fire suppression, and warm-air contractors are exempt from this requirement.

According to L&I, failure to comply with these new regulations will result in the issuance of a violation notice and will subject the contractor to a fine. Repeated or egregious violations may result in the suspension or revocation of the contractor's license. Given the occurrence of several widely publicized building collapses related to construction activities in Philadelphia, and increasing L&I budgets as a result, it is expected that inspections will be more rigorous than after past code changes.

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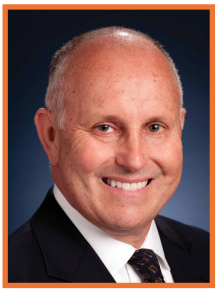
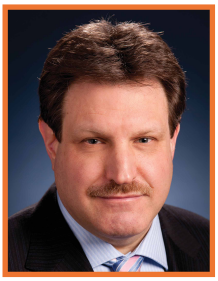
When Creating a Trust, Timing is Everything: Measures to Consider As You Preserve Your Assets for the Next Generation

By Wayne C. Buckwalter and Evan A. Blaker





Trusts are no longer exclusive tools for large estates, as a greater number of families with various levels of income and wealth are using trusts to pass on their assets to the next generation. If you can answer "yes" to any of the following questions, it is time to review and update your current estate plan.

- Do you have an existing estate plan that was developed in 2011 or earlier?
- Do you own real estate in more than one state?
- Do you have beneficiaries under the age of 40?
- Do you have beneficiaries with a disability, addiction or other issue?
- Do you have a significant portion of your investments in a retirement plan?

Trust advantages

A trust is an estate planning tool that can be used in a wide variety of circumstances to maximize the wealth passed on to beneficiaries, and also to set terms for how the funds can be used to address families' unique circumstances.

Even if you already have a trust established or an estate plan, it is important that these plans be updated, as laws change often. For example, estate plans created prior to the large increase in the federal estate and gift tax exemption and the implementation of portability may result in a surviving spouse facing unnecessary financial restrictions and expense. Under the new federal tax laws, a married couple with an estate up to $10,900,000 in 2016 (or $5,450,000 for individuals) may create a simple joint revocable living trust that will:1) Avoid the unnecessary probate process; and 2) Guarantee tax deferred distributions for non-spouse beneficiaries over the life expectancy of the ultimate trust beneficiaries, i.e. children, grandchildren.

Protecting and gradually handing over control to young beneficiaries

In the case of younger beneficiaries, a trust can be used to gradually transition control of assets, ensure the option of life expectancy tax deferred distribution of retirement assets, and protect beneficiaries from the claims of creditors and spouses. Rather than use a one-size-fits-all, cookie cutter approach, specific goals, personal preferences and personalities may be addressed when determining a plan that works for the family.

Overcoming challenges of creating a trust for beneficiaries with disabilities

A Special or Supplemental Needs Trust (SNT) is a specific type of trust that can be created by a parent or guardian to benefit a person with a disability. When drafted correctly, a SNT allows a person with a disability to benefit from funds placed in the trust while still receiving public benefits.

A SNT may be created using assets of the beneficiary (the person with a disability) or funds from a family member transferred to the SNT following death through an estate plan. The trust funds may be used for treatment, education and quality of life improvements for a person receiving public assistance. Rules and restrictions must be followed to allow the beneficiary of the trust to remain eligible for Social Security Income (SSI) and Medicaid by supplementing, rather than replacing, public benefits such as SSI and Medicaid.

SNT's have a special status for Medicaid purposes. Trust funds are not considered a "resource" of the beneficiary that could disqualify the beneficiary from Medicaid benefits, provided that the trust is for the sole benefit of a person with a disability.

How to plan for a beneficiary facing addiction

Successfully covering an addiction issue in a trust requires sensitivity and an understanding of the disease of addiction. Naming a family member or corporate fiduciary is often not the best solution. Consider naming a person in recovery as trustee of a trust created for the benefit of the addicted beneficiary, as he or she may be in the best position to fully understand the issues faced by an addict. Once the trustee determination has been made, the next issue is creating the terms of the trust, which may include giving the trustee broad discretion for using trust assets and income for treatment, including the decision of where and when.

The current tax laws are such that for the vast majority of people, a plan that requires no lifetime restrictions and complete flexibility is available. A timely estate plan can preserve assets and address the unique challenges faced by many beneficiaries.

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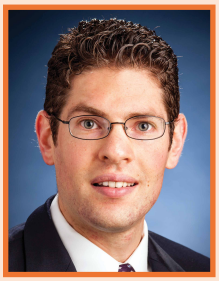
I've Been Terminated on a Construction Project – What Does This Mean?

By Shawn R. Farrell and Matthew L. Erlanger



A contractor fears few events on a project more than receiving a notice of termination. Receipt of the dreaded notice may arrive expectedly or as a surprise. Either way, termination does not always mean that the contractor must bear responsibility for the owner's costs to complete the project. Instead, the owner may bear responsibility if it incorrectly terminates the contractor.

Courts recognize three types of termination: termination for cause, termination for convenience, and wrongful termination. Frequently, "standard form" construction contracts, such as those published by the AIA, identify events of default that can result in termination for cause. Generally, the owner may terminate for cause if the contractor: (1) repeatedly failed to supply enough skilled workers or proper materials; (2) failed to pay subcontractors; (3) repeatedly disregarded laws; or (4) was otherwise in substantial breach of the contract. Many contracts require notice and an opportunity to cure the default before termination for cause. If the contractor timely cures, then the owner cannot terminate for cause. If properly terminated, the contractor may be liable for the owner's costs to complete the project.

Unlike a termination for cause, a termination for convenience may occur in the absence of a breach. However, the owner can terminate for convenience only if allowed under the contract. Termination for convenience provisions are commonly found in construction contracts and standard in AIA contracts. As long as the owner follows the procedure contained in the contract, it may exercise the right to terminate for convenience. In many states, the only limitation is that the termination cannot be made in "bad faith." What constitutes bad faith tends to be fact-specific. In a termination for convenience, the contractor has no liability to the owner. Instead, the contractor may typically recover its outstanding costs, plus overhead and profit for work it performed, unless the contract expressly limits a contractor's damages after the termination.

Lastly, if an owner had no basis to terminate for cause and did not exercise its contractual rights to terminate for convenience, then the owner breached the contract and the termination was wrongful. In that case, the contractor can recover its outstanding contract balance, as well as its expected profit on the project.

There is a caveat to the rule that an improper termination for cause constitutes wrongful termination. Sometimes the contract will include language expressly providing that an improper termination for cause gets converted into termination for convenience. This language is enforceable but is the exception rather than the rule. Generally, where there exists no cause to terminate, the termination is wrongful.

If terminated, contractors should always attempt to show that there was no cause to terminate. This process begins prior to termination. Specifically, at the owner's first suggestion that cause exists to terminate, the contractor should state its disagreement in writing. The contractor should also prepare documentation to rebut any contention that cause exists to terminate and to support any legal defenses, such as waiver by the owner of the schedule deadlines, impossibility of performance, or substantial completion (the project was substantially complete at the termination). Further, if the owner is correct that there is cause, the contractor should cure its default prior to the owner sending the notice to terminate. This enables the contractor to prepare a defense upon the notice to terminate and allows the contractor to avoid liability for the owner's completion costs.

The difference between termination for cause, termination for convenience, and wrongful termination can be the difference between having to pay the owner or recovering from the owner. Knowing how to proceed is of critical importance. The attorneys at Cohen Seglias Pallas Greenhall & Furman, P.C., are here to provide you with the legal advice to guide you through this process.

Shawn is a Partner and Matt is an Associate, both practicing in the Firm's Construction Group. They can be reached at (215) 564-1700, sfarrell@cohenseglias.com or merlanger@cohenseglias.com.

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