

25<sup>TH</sup> ANNIVERSARY 1980-2005

## It's A Celebration

*at LePatner's 25th Anniversary Gala*

Torrential rain couldn't keep over 25 years' worth of friends, clients, colleagues and the occasional adversary away from the Central Park Boathouse on November 9, 2005, a day proclaimed by Mayor Bloomberg\*, as Barry B. LePatner & Associates Day. Partners Victoria Drogin and Ronald Feingold each spoke about their experiences with the firm before introducing the firm's first client from 1980, Frank Munzer former President of The Eggers Group, and Barry LePatner himself. Thanks to everyone who planned, executed and attended this memorable night.



**Top:** Henry Korn, Sarah Orazio, Cathleen Pringle, Tadhg O'Connor, Elliot Duprey, Brad Cronk.  
**Middle:** Sidi Landa, Ronald Feingold, Barry LePatner, Victoria Drogin, Alex Ferrini.  
**Bottom:** Deborah Rubin, David Esterman, Lee Stumacher, Elvira Barisano, Lorraine Thompson.

\* See FIRM NEWS on back page

## INDEMNIFICATION: The Trap in Every Construction Project

By Henry H. Korn, Esq.

In any public or private construction project the principal players must understand the ramifications of standard indemnification provisions.

Typically, the owner/builder will hire a general contractor or construction manager ("GC/CM"). The GC/CM in turn will hire subcontractors to build the project. In construction manager contracts, the owner will occasionally hire the subcontractors directly. In both scenarios, the owner will have already hired an architect who provides services during the pre-construction and construction process. Typically, the GC/CM and the architect furnish the owner with the AIA form contracts to execute, but often, the owner never makes certain that these contracts are seamlessly drafted to link all project players together in a way that fully protects the owner – the only party responsible for funding the construction of the project.

In most instances, the owner's use of standard AIA form contracts provided by the construction and design team does not serve it well. Doing so sets up potential traps for the unwary owner. This article addresses the indemnification trap when disputes arise, litigation ensues and the owner attempts to resolve disputes.

The scenario is typical: The project has run over budget and taken far longer than the construction contract specifically contemplated. The GC/CM arbitrates the claim and in the course of the arbitration, the owner and claimant settle. However, the owner has a separate contract with the architect (in the case of the CM project, possibly with each of the subcontractors also) providing that the architect (or the subcontractors in the CM project) shall indemnify the owner from any claims, damages or losses arising out of the project. The standard form AIA Agreement between owner and architect (or subcontractors in the CM project) typically

Continued on next page

provides that the architect (or subcontractor) and its officers, agents, servants, or employees agree to defend indemnify and hold harmless the owner, or the GC/CM, for loss, damage or liability caused by the architect's or contractor's negligence in connection with the project.

The owner determines that certain errors and omissions by the architect or defective work by the subcontractors contributed to the GC/CM's claims. The owner then seeks to recover all or part of the moneys paid to the GC/CM in a separate proceeding brought against the architect or subcontractor.

The owner is in for a surprise it never contemplated. The settlement is subject to attack by the non-settling architect or subcontractor and the reasonableness of the settlement can be challenged.

The indemnification clause in the contract between owner and architect or GC/CM typically is intended to provide relief to the owner if the owner suffers damage or liability caused by the negligence of the non-settling architect or subcontractor. Where the owner did not require by contract or otherwise that the architect or subcontractor participate in the defense of the case, including the examination of witnesses under oath, and any settlement, the settlement by the owner is subject to challenge by the non-settling party. Moreover, under New York law, the architect or subcontractor would be entitled to broad discovery of evidence concerning the owner-GC/CM settlement so that the non-settling party can defend the indemnification cause of action.

New York case law cautions that when "the indemnitee [the owner] knows or believes that any financial responsibility he undertakes is likely to fall ultimately on the indemnitor, *he is not inhibited, except by the barest self-restraint.*" The discovery the architect or subcontractor will be entitled to obtain is broad enough to uncover one way or the other whether the owner's defense of the GC/CM's actions and settlement proved that it did not exercise

"self-restraint" in settling the matter.

This settled law in New York sets the strategy for the non-settling party to the owner-GC/CM litigation and settlement. New York law provides that where the owner gives notice to the architect or subcontractor, the indemnitor may then elect to defend the action. If the indemnitor elects to defend, then he will be bound by the outcome on principles of *res judicata*. If, however, the indemnitor declines to defend and the indemnitee is required to carry that burden, then the indemnitor is bound by any reasonable good faith settlement the indemnitee may make or any judgment that may be rendered against him.

However, if the indemnitee (the owner) fails to notify the indemnitor (architect or subcontractor), or having notified him, refuses to accept proffered assistance, the indemnitee proceeds at his own risk with regard to any judgment or settlement, which may ultimately ensue. In order to recover reimbursement, he must establish that he would have been liable and that there was no good defense to the liability.

Hence, the cautionary principle for the owner is this: In settling disputes in construction projects, the owner will be proceeding at its own risk in defending the GC/CM litigation and faces challenges to the litigation strategy and settlement unless the owner agreements with the architect, GC/CM and subcontractors impose the obligation on them to cooperate with the owner in any disputes and claims raised on the project. It is also prudent for the owner to provide notice of the pendency of the lawsuit to the indemnitor.

## One-Stop

More and more frequently, our owner clients ask us to include in their construction agreements contract provisions which reflect the owner's decision to utilize an Owner Controlled Insurance Program ("OCIP"). OCIPs are frequently used in large construction projects of \$100 million or greater or in the case of multiple ongoing projects. An OCIP is a wrap policy encompassing all of the work performed on the project, covering the owner and all of the parties on the construction team. It is administered by the same broker and same insurance company - a single source. In effect, what an OCIP does is manage a single insurance program to cover risks confronting the owner, as well as the construction team, which generally consists of the construction manager or general contractor and the subcon-



Joseph Jaffe and Mark Chersevani of UHY Advisors FLVS chat with Howard Safir of SafirRosetti and Henry Korn.



Michael Mosely, Associate Counsel of Goldman Sachs, with Barry LePatner.



Central Park Boathouse operator and LePatner Dean Poll, greets Barry and his longtime partner Barry Grunfeld of Grunfeld Desiderio Lebowitz &

# Shopping: OWNER CONTROLLED INSURANCE PROGRAM

By Ronald B. Feingold, Esq.

tractors. The types of insurance coverage generally included in an OCIP is general liability, excess liability, builder's risk insurance and workers' compensation. Under an OCIP, one entity, usually the owner, purchases all of the policies which will cover the project claims.

There are multiple benefits should the owner purchase an OCIP. One advantage is reduced insurance costs. An OCIP is placed on a project basis, generally for two years or longer. The premium is placed at the commencement of the project and locked in for at least two years. In addition, the owner is able to pass the insurance cost to the construction team. Traditionally, the construction team includes its insurance costs in its contract bid price. Should the owner contemplate using an OCIP, subsequent to receiving the construction team's bid, the owner can deduct those insurance costs from the construction manager's/general contractor's ("CM/GC") bid, thereby reducing the contract price. At that point, the owner may also elect to charge back the OCIP's insurance costs to the construction team.

In addition, since the owner is soliciting insurance coverage for itself as well as the entire construction team, the owner can strengthen its negotiating position with the insurance carrier for reduced insurance premiums.

Further, an OCIP frequently includes a very thorough coordinated safety program, which serves as an added incentive for the insurance carrier to reduce the insurance premium. As a result of the implementation of project safety programs for the construction team, there is the potential for a reduced number of project site accidents, which in turn sensitizes the insurer to reduce the insurance premium. Generally, contractor insurance programs

lack coordination and safety plans among the CM/GC and trade subcontractors.

An added benefit stems from the fact that OCIPs are placed on a project basis. Since conventional contractor insurance policies are placed annually, a CM/GC and/or trade subcontractor could potentially sustain a loss of coverage during a project under the traditional insurance coverage program. For example, a CM/GC and/or trade subcontractor may be named in any number of lawsuits during a given year. In the event liability

insurance proceeds are used to pay for any number of plaintiffs' claims during a given year, the remaining available insurance monies for additional claims are reduced for that year. So, an owner having a claim against its CM/GC may obtain a favorable award, but find itself restrained by a situation where there are no insurance proceeds from

which to collect the award. Not so with OCIP. Since an OCIP is placed solely for the project (and provided the owner maintains a sufficient amount of insurance for the entire project's construction team) there should be ample insurance monies available for an owner's award.

Still another advantage is that the owner has better control over coverage terms and conditions under an OCIP. Under a traditional construction team's insurance program, an owner may be unable to confidently verify that the construction team has procured an adequate amount of insurance or the kinds of insurance required by the contract documents. An owner usually relies upon

***Under a conventional insurance program, contractors are often underinsured, thus exposing the owner to claims brought by third parties.***



Patner client, friend Harold & Silverman LLP.



Barry Marin, CPA, Joe Piasecki and Paul Bello of AKF Engineers, clients of the firm since the 1980's, enjoying the festivities.



Structural engineers Phil Murray and Ramon Gilsanz of Gilsanz Murray Steficek LLP, approved of the hors d'oeuvres and buffet.

## OCIPs *continued from p3*

the insurance certificate submitted by the CM/GC, without reviewing the actual policy. Thus, the owner cannot truly know whether the CM/GC has maintained the coverage for the necessary period of time. Nor can the owner ensure that the CM/GC has not exhausted a portion or large part of the coverage on other claims and projects. Under the conventional insurance program, CM/GCs are often underinsured, thus exposing the owner to claims brought by third parties. Under an OCIP, since the owner controls the amount of insurance maintained for the project, it is more likely that there will be an adequate amount of insurance coverage.

While these are the many benefits that accrue to an owner as a result of an OCIP, at the same time, the owner must ensure that it obtains a sufficient amount of insurance coverage for the entire construction team. The policy cannot be replaced during the policy period, and it is imperative that the owner avoids a situation where there is an exhaustion of insurance monies should several claims be asserted against the construction team.

What is the likely scenario with an OCIP in place should a claim arise as a consequence of the project? Should a claim be asserted against the owner, the owner should submit the claim to its broker/insurance company. The insurance company handles the owner's

claim, as well as any other claims filed by the construction team, on an individual basis. The owner may elect to have a self-insured retention of, for example, \$100,000, in which case, the owner pays the first \$100,000 towards the claim. A claims manager (third party administrator, known as the "TPA") administers the claim and charges the owner a designated fee. The TPA, working and negotiating on the owner's behalf, may seek to dispose of the case as soon as possible in order to limit the owner's costs and expenses.

Under a second option, the owner may choose a \$100,000 deductible, in which case the insurer pays the deductible and seeks reimbursement from the owner. Under this scenario, the insurance company has more control over how the first \$100,000 is expended. In all other respects, the owner's claim under both options is handled by the insurance company in the same fashion.

Having summarized the several benefits of an OCIP, there is little surprise when our owner clients tell us that they are opting for an OCIP when undertaking their large construction projects. All owners should carefully consider this program to help reduce their premiums, avoid a loss of insurance coverage and maintain better control over their insurance coverage. At the end of the day, an OCIP will help an owner in maximizing the profit margin realized from its construction project.

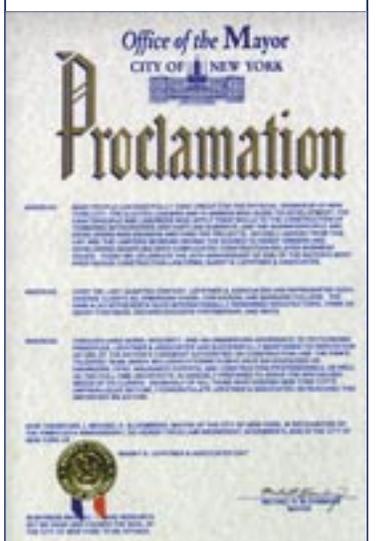


Douglas Benach, President of Property Development at Greystone.



Partner Victoria Drogin greets Salvatore Costa, Vice President of Sterling National Bank.

## FIRM NEWS



In recognition of LePatner's 25th Anniversary of doing business in New York City, Mayor Michael Bloomberg proclaimed November 9, 2005 as Barry B. LePatner & Associates Day. Thanks, Mike!

University of Chicago Press has agreed to publish Barry LePatner's new book, **Broken Building**, a critical look at the socio-economic reasons why construction remains one of the nation's least efficient and least productive industries.

LePatner is pleased to collaborate once again with SafirRosetti, renowned corporate investigators headed by former NYC Police Commissioner Howard Safir, on a matter involving construction projects for a major N.Y. medical facility. This will require an audit of the past performance of the project's construction manager and preparation of new agreements for upcoming projects.

### QUOTE OF THE QUARTER

"To be persuasive, we must be believable.  
To be believable, we must be credible.  
To be credible, we must be truthful."

Edward R. Murrow

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