
Effective Legal Risk Mitigation and Risk Management in the Construction Industry

By Martin S. Frenkel

Whether it be commercial, single family residential, retail, or multi-family residential, to name a few, construction is perhaps one of the most truly satisfying industries in our economy. In a world which is increasingly digital and ephemeral, construction is a creative industry that alters, often permanently, the physical landscape. Before one's eyes, you can literally see the transformation – from a decrepit building long neglected and now brought back to life through rehabilitation, to vacant land converted to a thriving new neighborhood. Construction is complex, multi-faceted, and unfortunately, replete with both financial and legal risk.

Serving as outside General Counsel for various construction companies over the years has brought this latter issue – the interplay between financial risk and legal risk — into distinct focus. What exactly is the lawyer's role in the construction industry? Simply and succinctly put, it is as follows: limit risk to the extent possible within the confines of advancing business goals and, when risk results in loss or potential loss, control the fallout as fully and immediately as possible.

Four factors coalesce in the construction industry to make an understanding of this lesson critical: (1) the sheer complexity of physical construction and its relationship to liabilities of every nature and kind such as from errors in construction, design defects, contractual breaches to both project owners and subcontractors, physical jobsite injuries, exposure to governmental regulators, and limitations imposed by project funders to name a few; (2) narrow profit margins imposed by extreme competition in the marketplace; (3) the occurrence of liabilities during the course of ongoing performance of a project creating a risk management whipsaw between continued performance and ceasing performance; and (4) limitations on collection options due to undercapitalized subcontractors or single purpose owner entities with limited assets which are frequently beyond the contractor's reach due to the existence of first priority secured lenders.

To be blunt, litigation relating to disputes is, and always will be, an option. However, it is often not the first option, and it is certainly not the first line of defense for the general contractor. Litigation as an option is impacted by numerous considerations including the fact intensive nature of construction disputes (potentially limiting the ability to speedily and cost-effectively dispose of litigation), the necessity of complying with contractual dispute resolution procedures, and the availability of non-litigation options such as the ability to assert a construction lien (having an impact on project funding) or to stop work. That said, these options are primarily ones of **risk management**. The cat is already out of the bag; an actual dispute exists and now it is time to minimize or clean up the mess.

A far more effective approach is that of **risk mitigation**. Attempting to eliminate problems before they arise, or to reduce the impact of those problems while they are still in the nascent stages is key. It is here that the construction lawyer can truly add value. What are some the essential elements to construction industry legal risk mitigation?

1. **Contract Drafting:** Ensuring that general contracts have clear, understandable, and impactful obligations for performance by both owner and contractor, as well as available remedies to the contractor short of litigation. With regard to subcontractors, one needs to make sure that there are clear and established metrics for measuring subcontractor performance both in terms of workmanship and scheduling adherence, and that there are appropriate risk shifting provisions such as robust indemnification and insurance provisions.
2. **Early Problem Identification and Intervention:** Establishing a process to quickly escalate issues from the field, to management, and then to legal is crucial. Early identification of issues, evaluation of options for addressing those issues (including in project dispute resolution), and creating contemporaneous documentation of issues are primary to keeping issues manageable before the company is faced with only bad choices.
3. **Legal Oriented Field Training:** Closely related to early problem identification and intervention is the training of field personnel. These personnel need to be educated in how to spot “litigation moments” in construction, when to escalate them to management, as well as the concepts of timely and effective notice to third parties.
4. **Creation of Processes for Measuring and Documenting Owner and Subcontractor Performance:** A process must be created between field

personnel, management, and legal for tracking and maintaining (a) contract formation documents (i.e. the original contract, change orders, schedule, and schedule changes); and (b) contract performance documentation such as default notices and notices of excusable delay.

5. **Pursuit of Timely Risk Shifting Options:** Because general contractors are often caught between the proverbial rock (the project owner) and the hard place (the subcontractor), it is fundamental for the contractor to engage in effective risk shifting as early as possible. Risk shifting typically occurs in circumstances involving excusable delays, indemnification, bond claims, and insurance claims. Simply stated, when a loss occurs or appears likely to occur, the contractor must quickly act to shift the potential loss to third-parties who may bear such loss. However, these remedies demand diligence to avoid waiving them through such assertions as untimely or ineffective notice to third-parties and the resulting prejudice to those third-parties.

Providing effective risk mitigation and risk management by the construction lawyer is no easy task. It demands pragmatism, business savvy, an understanding of how the elements of construction projects relate to one another, and most importantly, creativity. Finally, the most important component is a close partnership between field personnel, management, and legal. Without robust and regular communication channels, as with project estimating misses and lack of drawing details, the result is rarely good.

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