THE LEGAL SPOTLIGHT

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The Construction Manager: Owner's Agent or Independent Contractor?

There has been a number of reported cases in which subcontractors have sued owners with whom they have no contracts to recover payment for material or labor provided on a construction project. Such a lawsuit can materially increase the potential exposure of an owner, particularly if the owner has already paid the contractor. The basis for subcontractors' actions against owners and what the owners can do to protect themselves are the subjects of this article.

There are two conventional remedies of subcontractors, material-men and vendors:

The first is a breach of contract action against the party that engaged them. Generally, the object is to obtain a judgment for damages that will be a charge on all the unencumbered assets of the defendant-judgment debtor.

The second is to record a notice of lien against the property improved by the materials or labor the subcontractor, material-man or vendor provided.

Occasionally, neither remedy gives complete relief. Take, for example, the situation where the owner has substantially paid all it owes to the general contractor, but the general contractor has not paid the subcontractors and is insolvent or has no apparent assets. A breach of contract action by a subcontractor against the general contractor for money damages may result in an uncollectible judgment. A lien against the property may not be enforceable for the full amount owed because of the statutory limitation on an owner's liability.

Section 4(1) of New York's Lien Law provides that: "In no case shall the owner be liable to pay by reason of all liens created pursuant to this article a sum greater than the value or agreed price of the labor and materials remaining unpaid, at the time of filing notices of such liens [subject to limited exceptions for advance payments and collusive conveyances under Lien Law §7]."

The rationale of the statute is to protect the owner from multiple liability for duplicative liens against his property. Such a situation can be easily illustrated by the following example: A piece of equipment valued at $10,000 is sold by a vendor to a material-man, who sells it to a subcontractor, who sells it to a contractor, who sells it to the owner. The owner pays the contractor all but a $1,000 retainage, but the contractor does not remit payment to the subcontractor. The vendor, material-man and subcontractor each can file a lien against the property in which the equipment has been installed, each lien including the value of the equipment. In other words, three liens totalling at least $30,000 are filed against the owner's property because the subcontractor, material-man and vendor were not paid for a $10,000 piece of equipment for which the owner has already paid the general contractor all but $1,000.

The statute protects the owner in this situation. The aggregate value of the liens filed by the subcontractor, material-man and vendor cannot exceed $1,000. Their liens cannot be enforced for more than $1,000.

What is the subcontractor to do? On the one hand, he is faced with liability to the material-man for payment for the equipment. On the other hand, he has no effective remedy against the general contractor to recover the payment, and no effective remedy under the Lien Law.

Occasionally, a subcontractor will seek recourse against the owner, alleging that the contractor is the owner's construction manager and agent, that the construction manager acted on behalf of the owner in contracting with the subcontractor and that, based on the principal of *"respondeat superior,"* the owner is directly liable to the subcontractor.

From the perspective of the owner, and occasionally the courts, the subcontractor's claim against the owner is "an afterthought borne of a desire... to recoup for the injustice done to [the subcontractor] by the general contractor." However, the claim reflects an apparent perception among many in the construction industry, including some lawyers, that the distinction between construction manager and general contractor is the same as that between agent and independent contractor; that a construction manager is the owner's agent and a general contractor is an independent contractor.

Although in fact that may be a general perception, in law the perception has no

merit. Whether a contractor will be held to be an agent of the owner does not turn on whether its role is described as construction manager or general contractor. Rather, the test is the same as that used generally in employment cases to determine whether one is an employee or independent contractor: does the employer, the owner in our example, control the contractor's means of production, or does the contractor bear the entrepreneurial risk of production for cost, timeliness and quality of construction. Under this test, a construction manager might be the owner's agent, it might be an independent contractor or it might be both, an agent during the planning and design phase of the project and an independent contractor during the construction.

The practical difficulty of this test is that its application depends on the facts of each case. Generally in a litigation, if the facts are in dispute, a trial is required, but the case can be tried only after an often lengthy and costly process of pleading, discovery, motion practice and waiting for the case to rise to the top of the court's trial docket. This process takes months and often years. A subcontractor's claim against an owner may have no merit, but because the merits may not be decided for a long time, the subcontractor's lawsuit against the owner puts the owner in a difficult position of having to make a Hobson's choice: pay a settlement to the subcontractor or pay legal fees to litigate. The owner must take into account which course of action is less costly in the short-term and in the long-term. Settlement of a particular subcontractor's claim may be less expensive than litigation, but if the owner develops a reputation for settling such claims, it may encourage more claims in the future.

An owner can improve its position considerably by including in its construction management agreement a provision that disclaims any liability to subcontractors. The particular language may vary ("Nothing contained in the contract documents shall create any contractual relation between the Owner and any Subcontractor," or "Nothing contained in this Agreement shall create or be construed to create a contractual relationship between the Owner and any third party"), so long as the disclaimer is clearly expressed.

To bind subcontractors to the owner's disclaimer of liability contained in a construction management agreement to which the subcontractors are not parties, the subcontracts between the subcontractors and construction manager should incorporate by reference the terms of the construction management agreement. For example, the American Institute of Architect's Standard Form of Agreement Between Contractor and Subcontractor (AIA Doc. No. A401-1987) includes a representation that the prime contract with the owner has been made available to the subcontractor and provides that the prime contract is one of the subcontract documents.

The purposes of the owner's explicit disclaimer are to make it clear to the subcontractors, and indeed, through their acknowledgement of the disclaimer, obtain their agreement, that they have no contractual recourse against the owner; avoid a long and costly litigation over the construction manager's role as agent or independent contractor; and give the owner a basis to move to dismiss the subcontractor's claim at the outset of litigation.

What, then, is the answer to the question: Is a construction manager an agent of the owner? It can be. What is the consequence for the owner? Increased potential liability and almost certain additional expense. What can the owner do to protect itself? Include in the contract documents a disclaimer of owner liability to subcontractors, and an acknowledgement by the subcontractors of the owner's disclaimer. It is a simple expedient and an example of how advance risk analysis and litigation planning can save money.

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