

THE CONSTRUCTION LAW BRIEFING PAPER

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LEGAL AUDIT: A SELF-ASSESSMENT TOOL FOR DESIGN & CONSTRUCTION COMPANIES
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THE NEW BUSINESS YEAR

The '06 business year is upon us. Last years' financial statements are being tallied and we hope yours was a pleasant one. As we place old audits in the filing cabinet, we want to suggest a proactive audit for the New Year.

We assume everybody has completed their strategic business plan and set some performance goals, but it is often difficult for management to critically analyze its business risks while consumed in production. Based on this annual dilemma, we decided to do something out of the ordinary with this month's Briefing Paper. We are enclosing a legal audit that we created for design and construction professionals. The goal of this audit is to provide you with a practical tool to analyze cross sections of your operation and identify risks that can be eliminated in 2006.

We begin our audit by looking at "the project" and some of the most common risks associated with contract documents. We then review issues found during project performance, such as differing site conditions, scheduling delays, safety and OSHA compliance, changed and extra work, and proper notification. A risk common to all projects is labor, so we also look at both Union and Merit Shop issues. We

complete the project analysis by addressing the ever present payment questions.

Shifting the focus to home office operations, our audit examines insurance concerns, followed by the related topic of bonding. Next, we broadly outline the legal issues of your company as an employer. That leads us to analyze a group of corporate topics, including accounting and taxes, real estate, estate and succession planning, and banking issues.

In conclusion, we touch on the rapidly evolving field of information technology and electronic recordkeeping, which will be addressed in greater detail in a forthcoming Briefing Paper. We hope you find the audit to be a useful tool to identify and minimize the risks your business faces in the New Year.

ANNOUNCEMENTS

Congratulations to Patrick J. Lee-O'Halloran who was named a "Rising Star" by the Minnesota Journal of Law and Politics.

Members of our firm will be participating in the following events in the coming months:

PHCC Seminar (Alexandria, MN)	2/08
AGC ND Seminar (Fargo, ND)	3/01
ABC National Seminar (Weston, FL)	5/04

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Yes No

I. Project - Contract Documents

- a. Do you deal with customers or subcontractors without a written contract governing your relationship?
- b. Do you have standardized contracts in place with your regular vendors?
- c. Do you have standardized general contracts and subcontracts in place?
- d. Are there provisions in the company's standard form contracts that limit the company's liability?
- e. Are you obtaining and reviewing other contracts and documents that are incorporated into your contract by reference?
- f. Do your employees know how to identify onerous contract clauses and to avoid unreasonable exposure to contractual risk?
- g. Do you enter into contracts requiring you to indemnify others for their negligence; or to obtain insurance covering others for their negligence?
- h. Prior to contract execution, do your employees read the terms and conditions for unfavorable contract clauses and then attempt to negotiate more favorable clauses?
- i. Do you begin performance prior to signing a contract?
- j. Do you obligate yourself to obtain permits even if governmental approval of the plans is not in your control?
- k. Does each contract allow the prevailing party to recover collection, investigation, and litigation costs?

II. Project – Differing Site Conditions

- a. Do your contracts contain a Type I and Type II differing site conditions clauses?
- b. Do you complete and document a pre-bid site inspection that includes digital photos prior to every proposal?
- c. Are you clarifying and documenting your assumptions about unforeseeable site conditions in your proposals?

III. Project – Scheduling / Delays

- a. Do you prepare or receive periodic schedule updates?
- b. Do you revise your project's critical path with each schedule update?
- c. Does your schedule identify each impact and the resulting delay between updates?

Yes No

- d. Do you have a written procedure for documenting construction delays that occur on a project?
- e. Do you prepare and submit a detailed "As Proposed" manpower loading schedule at the start of a project?
- f. When a project schedule is compressed or delayed are your employees calculating labor and supervision inefficiencies, documenting equipment costs, and keeping track of extended field and home office overhead costs?

IV. Project – Safety / OSHA

- a. Do you have a written evaluation process that includes a test to document that applicants are mentally and physically fit for duty?
- b. Do you have a written safety plan and do you document compliance with the safety plan?
- c. Are those who maintain your OSHA 300 logs properly trained?
- d. Do you have a written step-by-step post accident investigation and documentation procedure?
- e. Do you have a drug testing procedure and policy?
- f. Do you distribute safety materials and instructions to non-English speaking workers in their native languages?

V. Project – Changed / Extra Work

- a. Are your project managers proceeding with extra work before they have written approval from the Owner, Architect, and (if applicable) the General Contractor?
- b. Do you have a written procedure for segregating and documenting the costs associated with change orders or additional services requested by clients?
- c. Do you have written procedures in place to document and track constructive changes?

VI. Project – Notice

- a. Do you have a series of notice letters for standard issues?
- b. Do you have a summary of important notice provisions and contact information?
- c. Are your project managers aware of their notification deadlines on every project and do they submit notifications within the required period?

Yes No

VII. Project – Union Labor

- a. Have you considered double-breasting to expand your operation into other markets?
- b. Do you know the deadlines for non-renewals in your collective bargaining agreements?
- c. Are you aware of the differences between state and federal prevailing wage requirements and the difference between union and prevailing wage rates?
- d. Do you have a dual gate program ready for use?
- e. Have you examined jurisdictional craft boundaries since the reorganization of the national unions?
- f. Do you know how to exercise your rights, if you receive unsatisfactory union labor and find the local business agent uncooperative?
- g. Are you monitoring the union controlled defined-benefit plans that you partially fund, and do you have a plan to limit your liability in the event these funds become under-funded?
- h. Recognizing that unpaid union fringe funds of lower tier subcontractors file lien and bond claims, do you have a mechanism in place to ensure that your subs' payments to these fringe funds are current?

VIII. Project – Merit Shop Labor

- a. Has your company faced a union organization effort and do you have a plan and procedure in place to handle such an event?
- b. Do you have a written no solicitation / no distribution policy for your workplace?
- c. Do you sign contracts that contain a “harmony clause” requiring your workers to work without disrupting union workers which expose your business to delay and disruption claims?
- d. Are you aware of your rights and responsibilities regarding non-English speaking workers?

IX. Project – Payment

- a. Do you know on which projects you must give pre-lien notices?
- b. Do your employees have a comprehensive understanding of the procedures and deadlines for making a bond or lien claim on a project?
- c. Do your project managers understand how your payment rights differ when confronted with a “pay-when-paid” as opposed to a “pay-if-paid” clause?

Yes No

- d. Do your employees know the difference between partial, conditional, and unconditional lien waivers and how to use them without forfeiting your rights to other claims for payment?
- e. Do your employees know the rights of your suppliers and subcontractors to file bond claims and mechanic's liens?
- f. Do you know what options you have to obtain payment from a bankrupt entity?

X. Insurance

- a. Do you have coverage for the following:
- i. Assets – buildings, including improvements and betterments, office contents, computers, and leased and owned construction equipment.
- ii. Employee accidents – while on the job as required by statute (e.g., Worker's Compensation Insurance).
- iii. Third party claims for bodily injury or property damage (e.g., Commercial General Liability Insurance "CGL").
- iv. Motor vehicle liability (e.g., automobile insurance).
- v. Property damage claims for the work itself (e.g. property or Builder's Risk Insurance).
- b. Have you reviewed the exclusions and endorsements to your CGL policy to make sure you have your desired coverages in place?
- c. Does your CGL policy have a Completed Operations Exclusion?
- d. Does your CGL policy have a Residential or Habitational Exclusion?
- e. Does your CGL policy have a Mold and EIFS Exclusion?
- f. Are your limits of liability adequate for the hazards / risks of your business?
- g. Do you know who has the Builder's Risk policy on every project, its deductible, and its scope of coverage?
- h. Do you provide professional design services through subcontracts or otherwise, and do you have coverage for those activities which is normally excluded from coverage under CGL policies?
- i. Do you have any Pollution Liability hazards / risks and are they excluded from your CGL coverage?
- j. Do you have Employment Practices Insurance for discrimination and sexual harassment claims?
- k. Do you have a written fleet policy that has been accepted by your insurance provider?

Yes No

1. Are you required to be listed as an additional insured under your subcontractors' policies?
- m. Are the contractual indemnities you provide to others insured under your CGL policy?
- n. Do you obtain certificates of insurance, before work begins, documenting that your subcontractors have obtained all required insurance and named you as an additional insured?

XI. Bonding

- a. Have you reviewed the terms of the bond forms your surety provides to reduce the risk of claims?
- b. Is your surety company financially sound, Best rated and Treasury Department listed?
- c. Do you condition the dual obligee riders you provide?
- d. Does the surety have the ability and desire to support your business plan with adequate levels of surety capacity?
- e. Have you reviewed your General Agreement of Indemnity with your surety to reduce or eliminate personal liability?

XII. Employment / Labor

- a. Do interviewers know what they can and cannot ask of prospective employees?
- b. Do you have standard employment contracts in place?
- c. Do your employment contracts address the following:
- i. Salary and review periods?
- ii. Holidays, vacation, family leave, and sick pay?
- iii. Disciplinary / grievance matters and procedures?
- iv. Notice to be given by both parties?
- v. Confidentiality, intellectual property, and non-competition?
- vi. Discrimination and harassment?
- vii. Health and safety?
- viii. Pensions, commissions, bonuses, and overtime / flextime?
- d. Does your company have a written retirement plan?

Yes No

- e. Do you have a written procedure for documenting job performance complaints from clients and customers?
- f. Do you have an Employment Termination Meeting Checklist?
- g. Do your employees complete an Employee Exit Interview Form on their last day of work?
- h. Is there a written Non-Discrimination Policy in place?
- i. Is there a written Sexual Harassment Policy in place?
- j. Is there an written Internet Usage Policy in place?

XIII. Corporate / Accounting

- a. Are you properly licensed in your applicable area of construction?
- b. Do you limit liability through the creation of separate subsidiaries?
- c. If applicable, do your corporate directors understand *Sarbanes-Oxley* and what it means to them in terms of corporate responsibility and reporting?
- d. Do your directors have specific job descriptions in place that include responsibility for compliance?
- e. Are your corporate minute books for your shareholder, director, and corporate officer meetings up to date?
- f. If your company has more than one owner, do you have an agreement that defines the rights between the owners, such as a Buy/Sell Agreement, Stock Purchase Agreement or an Operating Agreement that sets out all rights and obligations of the parties if one of the parties dies, becomes disabled, or leaves the business?
- g. Have you updated your buy-out valuation as required under the agreements?
- h. Does the agreement above set out a funding plan for the buy-out?
- i. Are your proprietary designs and ideas protected with copyrights, trademarks, or patents?
- j. Have consultants and independent contractors signed appropriate Confidentiality Agreements?

XIV. Tax

- a. Have you considered the tax advantages of structuring as an LLC or Subchapter S Corp?
- b. Are you aware of the tax implications of the method of accounting that you use?

Yes No

- c. Are you personally liable for any business debts and, if so, have you examined ways to limit that liability?
- d. Are you properly capitalizing or expensing purchases?
- e. Are you paying Federal excise taxes?
- f. Do you qualify for a fuel tax credit/refund?
- g. Are you depreciating any equipment properly?
- h. Have you considered the tax advantages of creating a leasing company for your equipment?

XV. Real Estate

- a. Are your company's standard landlord or lease agreements up for renewal and renegotiation?
- b. Do you have a crane easement when the boom of your crane encroaches on others' property?
- c. Do you contractually allocate the risk of necessary site access easements?
- d. Do you have standard borrow and waste agreements for landowners near or adjacent to your project?
- e. Is your real property held in an entity separate from your operating business?

XVI. Estate and Succession Planning

- a. Does each of the owners of the business have an up-to-date estate plan?
- b. Do you know when estate tax is due and who will pay it?
- c. Do the owners have a will, living trust, and healthcare directive in place?
- d. Does the company have an emergency succession plan in place?
- e. Has that written plan been presented to the named parties, and have they accepted their responsibilities under the plan?
- f. Are the successors capable of fulfilling those duties, and do they have the necessary information and training to fulfill those duties?
- g. If equity ownership is involved in the succession plan, are tax implications to that transfer?
- h. Has the current ownership personally guaranteed the bonding credit?

Yes No

- i. Has the succession plan taken into account bonding capacity and the potential need for the new ownership to personally guarantee the bonding credit?
- j. Has the succession plan been approved by your bonding company?

XVII. Banking

- a. If your company has a bank line of credit, have there been discussions about what the company needs to do to have the bank eliminate or limit any personal guaranty requirement?
- b. Does the company maintain all of its deposits at the same bank that provides the line of credit?
- c. Is the company required to tell its customers to make all payments to a lockbox at the bank?
- d. Was the company's attorney involved in the initial documentation of the loan and any subsequent amendments?
- e. Does company management meet with the company's banker on a regular basis?

XVIII. IT / Recordkeeping

- a. Do you know for how long you are legally obligated to maintain project documentation?
- b. Do you have a procedure for archiving both printed and electronic materials?
- c. Electronic documents exchanged between office managers and job site supervisors such as e-mails, text messages, and facsimiles are regarded as documentation that you may have to produce in the event of a dispute or accident. Do you have a policy and procedure for maintaining and being able to economically retrieve such electronic documentation?
- d. Do you have an electronic data destruction policy?

CONCLUSION

As one can see from the length of this checklist, legal issues are involved in nearly every aspect of your work from employee relations, to insurance, to succession planning. You have more flexibility in crafting the appropriate legal arguments and documents if you do it "pre-crisis". It is also more cost effective to avoid a problem with proper planning than it is to clean up after a legal "accident".

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