1995 Newsletter Articles

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Economic Risks of Doing Business Abroad

By: Michael K. De Chiara, Esq.

Introduction

The last decade has seen the expansion of American architectural and engineering expertise throughout much of Europe and the Pacific rim. As domestic markets all but disappeared in recent years, American architectural and engineering firms have sought out work from Shanghai to Berlin in an attempt to develop enough work to sustain their practices. Many firms have had success in obtaining, executing and getting paid for their work in foreign countries. Concurrently, many firms have had success in obtaining and executing work but have found it difficult if not impossible to collect substantial portions of their fees for overseas projects. The focus of this article will include some pitfalls which the wary architect or engineer should be aware of and thereby perhaps avoid when executing foreign projects. This article will conclude with some examples of how some firms have successfully arranged for complete payment on their foreign projects.

Pitfalls of Foreign Projects

1. Enforceability. Few architects and engineers are properly advised on the contractual provisions which apply or which should apply to work done outside the United States. Advice on which contract provisions should be inserted and which provisions would be easily accepted both by custom and local laws is essential for any professional working on a substantial project in a foreign jurisdiction. Of course, many lawyers simply advise their clients to have their contracts made subject to the courts and the laws of a domestic jurisdiction, typically New York or California. The problem with this approach, is that the entity who the professional seeks to enforce its contractual rights against is often a corporate shell established in the foreign jurisdiction and regardless of what language you put in your contract the practical reality is that its enforceability in this country will be a practical impossibility. Therefore, the sophisticated professional working overseas understands that the contractual provisions may well provide some level of comfort with regard to liability, but will be essentially useless with regard to collecting fees.

2. Local Laws. Depending upon the country in which you intend to render professional services, there may be tremendous variations in the requirements for rendering professional services. For instance, there may be technical information and schedules which are required in plans and specifications which is not consistent with domestic practice. There may be local licensing and staffing requirements which are likewise at variance with domestic

practice. Further, there may be local conditions, ranging from the types of materials available with which to build, to unique climatic conditions to unanticipated geotechnical formations which might require, by code or the local equivalent, special provisions which professionals practicing in foreign jurisdictions must be made aware. Often, there are requirements in foreign jurisdictions that foreign professionals must joint venture with local firms in order to carry out projects. Similarly, virtually all foreign countries require a local professional to sign and seal all technical drawings and specifications. The prudent professional will use either his counsel or a local advisor to insure compliance with all local rules and regulations.

3. Taxes. Perhaps the one area where American firms doing business abroad have been hurt most significantly is not receiving proper advice as to prevailing tax treatment on work done in foreign countries. Two areas which must be understood are domestic taxes on foreign work and avoiding foreign taxes on the same work. There have been situations where the foreign taxes on the work performed by American architects and engineers have actually exceeded the fees they received for executing the work since the taxes in some jurisdictions are based upon the value of the project and not on the fee received by the professionals for the services rendered. In short, it is critical that any professional doing work abroad seek out and be properly advised as to the tax treatment for the services you are providing when working on foreign projects.

4. Currency Exchange. In the global economy in which we live, there are significant daily fluctuations in relative values of currencies of different nations. Professionals doing work abroad are subject to these variations and should act to limit, to the extent possible, this unknown danger. The simplest way to avoid the risk of currency fluctuations is to provide that payment for services will be in United States currency.

5. Language and Customs. Variations in language, and local customs, can create enormous unanticipated problems for American firms doing business abroad. Often local custom may fly in the face of written agreements in which case you can rest assured local custom will prevail. Similarly, misunderstandings concerning language will always operate against the best interests of the American professional working abroad. Therefore, it is imperative that extra time and effort be spent to insure that there are no misunderstandings concerning the terms of agreements and that, to the extent possible, local customs have been factored into the business side of the deal.

Practical Arrangements for Collecting Fees

There are two techniques which I have found to be highly successful in ensuring that my American architectural and engineering clients on major foreign projects receive full payment for their services. First, where possible, I always try to negotiate a substantial up-front fee, which, has been as high as 50% of the total anticipated fee (excluding fees for additional services). Of course, depending upon circumstances, you may not always be successful in obtaining as large an up-front fee as you would like.

Another technique is to provide in your agreement that if payment is not received within a short time (typically ten days or less) of completed services, the professional has the right to cease work. This provides a relatively short string on payments and the prudent professional will not extend services for significant dollars without prompt payment.

Finally, another technique is to provide in your contracts for payments tied to numerous discreet milestones and permitting the professional to cease its work if payments are not made. This again is a technique for closely matching payments to services rendered.

The greatest danger in providing services on foreign projects is for the professional to find itself in a position where it has already performed its services for the client and is awaiting significant payments. Under such circumstances, you can rest assured you will probably not receive payment for your services. Therefore, we employ the above techniques as well as certain others to position our clients as best we can to insure that they will receive the full amount of their fees on foreign projects.

JOINT VENTURES FOR INTERNATIONAL WORK: THE MEMORANDUM OF UNDERSTANDING

By: Michael S. Zetlin

In this global economy more and more architectural, engineering and construction firms are foraging overseas for profitable ventures. Lacking knowledge and experience of practices in the foreign locale, these firms are teaming with U.S. and foreign partners in pursuing international projects. These teams provide the necessary expertise to satisfy the technical, and possibly financial, demands of the foreign owner or agency. They also offer an ability to share the expenses that mount rapidly when searching for work overseas.

Despite the risks and costs associated with pursuing international work, your firm may have decided that prosperity beckons abroad. In fact, we will assume you have already targeted an alluring project. You have assembled your design, construction, and perhaps development, partners and have decided to submit a proposal. If everything works well, this project should be immensely profitable. At this stage, many firms start working feverishly to develop a proposal with nothing more than a handshake deal with their team members. You, however, are shrewder, and as a proactive thinker want to minimize the chances that your relationship with your partners will turn sour.

The dangers should be apparent of proceeding without an explicit understanding of certain critical issues with your partners; issues such as the interest of each partner in the new entity that may be formed to design and/or construct the project; the sharing of expenses for responding to the RFP; the decision making process to be used throughout the development of the proposal. If the parties disagree on a decision, such as the format for the proposal, how does it get resolved? Should members of the joint venture be permitted to participate with other competing teams? Are there any prohibitions on the use of confidential or proprietary information? These and other issues should be discussed and decided at the outset of the venture and incorporated in a Memorandum of Understanding.

The Memorandum of Understanding should identify the role of each party, such as who the prime contractor will be for the venture and which risks will be assumed by the other partners. For example, the foreign contractor may be the prime contractor because it may have the exclusive ability of procuring required bonds in the foreign land or it may have the all-important relationship with the client. The Memorandum should identify which representative or representatives will serve as the liaison with the client.

The Memorandum of Understanding should also provide for the structure of a Management Committee. Each partner should have a representative on the management committee. If internal disagreements arise, a dispute mechanism procedure should be established. The committee should be responsible for allocating responsibility to the partners and for supervising the preparation of the proposal. The management committee may or may not be the same controlling group after the joint venture is awarded the project.

The Memorandum of Understanding should also include a prohibition against any member of the joint venture from soliciting or negotiating with other potential competitors.

Indemnification provisions should also be discussed and incorporated in the Memorandum of Understanding. For example, a provision may be inserted protecting each partner from the unauthorized actions of another partner. Significant harm could arise, for example, if one team member unilaterally decided to alter the bid. Likewise, the partners should be protected against copyright infringement that may occur by another partner.

If parties will be sharing trade secrets or confidential information, a contractual commitment should be made that the proprietary information shall not be disclosed to third-parties nor used for any purpose other than for the project.

In the event of default, such as failure to meet deadlines, the Memorandum should provide for appropriate remedies such as monetary relief or termination from the joint venture. The parties can identify the actions that shall be deemed a serious enough default to trigger monetary damages or termination.

These issues highlight some of the dangers that can arise during the bid process and steps that can be implemented to protect all parties. In the international marketplace, these extra precautions will assist in reducing the substantial risks that are always present. To avoid misunderstandings and help turn your relationship with your partners into a successful joint venture, discuss significant issues early and incorporate your understanding on each of these issues in a Memorandum of Understanding.

BANKRUPTCY AMENDMENT CURBS DELAYS BY SINGLE ASSET DEBTORS

By: Raymond T. Mellon, Esq.

For many years, a default by a single asset mortgagor would put lenders in a difficult predicament which required careful analysis. The lender would first have to determine the current value of the real property and estimate the time required to obtain a judgment of foreclosure and sale in the ensuing foreclosure litigation. The second, and more difficult analysis, was the effect of a probable bankruptcy filing by the single asset mortgagor, usually on the eve of foreclosure. The imposition of the automatic bankruptcy stay upon bankruptcy filing halts foreclosure and substantially extends the period of time in which a secured lender must wait to recover, in whole or in part, the proceeds of its loan.

In recognition of these problems, Congress recently enacted amendments to the United States Bankruptcy Code (the "Code") that seek to reduce such delays in foreclosure. These amendments provide relief from the automatic bankruptcy stay where a bankruptcy filing is made by a "single asset debtor." While these amendments will not impact upon the byzantine procedures of state foreclosure law (which is beyond the scope of this article), they will limit the delay that certain single asset debtors can obtain through the filing of a Chapter 11 bankruptcy petition.

The amendment to Code §362(d) does not apply to all debtors that only own a single parcel of real property. Instead, under Code §101(51B) Congress defined "single asset real estate" to be real property (other than residential property with fewer that four residential units) "which generates substantially all of the gross income of the debtor." Additionally, the debtor must not be engaged in any other business other than operation of the real property and the debtor cannot have non-contingent, liquidated secured debt in excess of $4 million. Upon a Chapter 11 bankruptcy filing by a debtor that owns "single asset real estate", Code §362(d)(3) imposes a time limit for the duration of the automatic bankruptcy stay. Within 90 days of the commencement of the bankruptcy case, the debtor must file a plan of reorganization that "has a reasonable possibility of being confirmed within a reasonable time". Alternatively, the debtor has the option of making monthly payments of interest to each secured mortgagee of the real property. The monthly interest payments must be at a market rate based upon the value of the mortgagee's interest in the real property. Unless the single asset debtor proposes such a confirmable plan of reorganization, or makes the required monthly payments of interest, the automatic bankruptcy stay shall be lifted upon a secured mortgagee's request.

The evident purpose of the bankruptcy amendment is to minimize the delay in foreclosure by compelling a single asset debtor to quickly pursue its bankruptcy case or to provide the secured mortgagee with monetary protection from any delays. Since a great deal of the bankruptcy filings by single asset debtors will not result in a successful plan of reorganization, a debtor's time for delay is now limited. If sufficient equity exists in the real property, the debtor may be in a position to either quickly proffer a confirmable plan of reorganization or to make monthly interest payments. However, if the real property is truly underwater, the secured mortgagee can have the automatic stay lifted 90 days after the commencement of the bankruptcy case.

While the amendment does not universally apply to all single asset debtors, it provides a measure of relief for secured mortgagees. However, there are significant gray areas that may engender litigation. First, controversy may flare over whether a debtor has filed a confirmable plan of reorganization. Also, the secured mortgagee and the debtor may differ over what constitutes a fair market rate of interest. These issues will be addressed by the decisions of bankruptcy courts in cases filed after October 22, 1994, the effective date of the amendments.

Since the effective date of the amendments, the primary issue decided in reported bankruptcy cases related to qualification as a single asset debtor under Code §101(51B). This threshold issue is crucial in determining whether Code §362(d)(3) is applicable. Due to the evident benefit that mortgagees will achieve through the application of Code §362(d)(3), they have sought an expansive construction of "single asset real estate". For example, in the case of In re Kremko, Inc., 181 Bankr. 47 (Bankr. S.D. Ohio 1995) the Court analyzed the dual issue of whether (i) a marina constitutes single asset real estate, and (ii) whether the debtor conducted any substantial business other than the operation of real property. While it was undisputed that the secured debt was well below $4 million, the Court held that Code §362(d)(3) did not apply, and refused to lift the automatic stay. In making its determination, the Court utilized concepts of real estate law to determine that a marina, with its docks and accoutrements, cannot be construed to be single asset real estate. The Court also held that the marina was not real property held by the debtor simply for the purpose of generating income. Instead, the business of the marina was the provisioning and mooring of boats. While this imaginative attempt by a mortgagee to expand the scope of Code §101(51B) was unsuccessful, bankruptcy courts have taken pains to apply Code §362(d)(3) to lift the automatic stay in appropriate cases.

The determination of whether semi-detached houses constituted single asset real estate held by a debtor was the relevant issue in the case of In re Philmont, 181 Bankr. 220 (Bankr. E.D. Pa. 1995). In that case, the mortgagee attempted to utilize Code §362(d)(3) to obtain an order lifting the automatic stay 103 days after the combined bankruptcy filings by the general partner and limited partnerships that developed the real property. As of that date, the debtors had not filed a plan of reorganization. The debtors argued that Code §362(d)(3) did not apply because semi-detached houses should be considered as individual single properties. In rejecting the debtors' argument, the Court relied upon the definition of single asset real estate found in Code §101(51B) which includes "a single property or project". The term "single project" was found to include a series of semi-detached houses.

Based upon the few reported cases which have construed Code §§101(51B) and 362(d)(3), it appears that the bankruptcy courts carefully analyze the relevant facts of each case to determine if a property constitutes single asset real estate for which the automatic stay should be lifted. To date, it appears that the courts are cognizant of the congressional intent in enacting the amendments, and are ready to provide relief to mortgagees when qualifying single asset real estate is at issue.

While the amendments allow bankruptcy courts to issue an order extending the 90 day period, "for cause", it is hoped that such extensions will not be given freely. Instead, bankruptcy courts should carefully evaluate the debtor's actions during the 90 day period to determine whether a confirmable plan of reorganization is being formulated. If the bankruptcy courts are not vigilant in imposing exacting standards for an extension of the 90 day period, the purpose of the amendments will be defeated.

Secured lenders have long been subjected to unreasonable delays in the bankruptcy courts in recovering the value of their loans on single asset real estate. In fact, bankruptcy filings have often caused a further diminution of the value of a secured lender's interest in single asset real estate. The recent amendments to the Code seek to redress this imbalance by compelling debtors to quickly establish whether reorganization is a viable option. If this cannot be established within 90 days, a secured creditor can now request that the automatic bankruptcy stay be lifted to allow the sale of the real property at foreclosure.

Highlights of the New Jersey Lien Law - Part I

By: Kenneth H. Lazaruk, Esq.

Historically, the Construction Lien Law in New Jersey has been both complicated and confusing. In recent years changes to New Jersey's Construction Lien Law have been made with the intent to simplify the filing and enforcement process. However, confusion still exists as the right to lien and the filing of process. The purpose of this article is to simplify the technicalities with regard to the New Jersey Construction Lien Law and to provide a synopsis of the highlights of the recent changes.

In this issue of the newsletter, the topics of (i) Entitlement to Lien, (ii) Filing requirements and (iii) Amendment of Lien will be discussed. The next issue of the newsletter will discuss (i) Enforcement, (ii) Residential Construction and (iii) Notice of Unpaid Balance.

1. <u>Summary</u>

In 1994 the old New Jersey mechanic's lien law was replaced with New Jersey's new Construction Lien Law (NJSA 2A:44A). The new construction lien law applies only to private projects, no new lien rights were created for public works projects which are still governed under the municipal mechanic's lien law. The new New Jersey construction lien law differs from the old mechanic's lien law in two primary areas: (1) the abolition of any pre-filing requirement and (2) the barring of contract clauses which prohibit the filing of the lien.

The abolition of any pre-filing requirement simply applies to the pre-filing requirement under the old New Jersey lien law of either a Notice of Intent or the filing of the prime contract with the County Clerk before a lien could be later placed against a project. Second, many owners of projects in order to frustrate contractors and avoid the risk of subjecting their projects to mechanic's liens incorporated clauses in their construction contracts to prohibit the filing of mechanic's liens. The new New Jersey construction lien law provides that liens may not be prohibited by contract clauses or agreements. Such clauses are void as a matter of public policy.

2. <u>Who Is Entitled to File a Construction Lien</u>

The new New Jersey construction lien law provides that any contractor, subcontractor or supplier who provides work, services or materials pursuant to a contract shall be entitled to lien for the value of the work or services performed or materials or equipment furnished in accordance with the contract. General or prime contractors, construction managers and design professionals (architects, engineers and land surveyors) have lien rights. In addition, these lien rights extend to two tiers below the prime contractors. These would include subcontractors and sub-subcontractors, subconsultants and sub-subconsultants. Below sub-subcontractors and sub-subconsultants no lien rights exist. In addition, no lien rights exist for suppliers to suppliers. In addition, the lien law defines "contract" as any agreement amendment in <u>writing</u> evidencing the respective responsibility as a contracting party which in the case of a supplier shall include a delivery or purchase order signed by the owner, contractor or subcontractor having a direct contractual relationship with the contractor or an authorization of any of them. Accordingly, in order to have the right to lien there must be a written agreement.

<u>Type of Project that can be liened</u>

Section 2A:44 A-4 provide for the attachment of Lien to the following projects:

a. dock, wharf, pier, bulkhead, return, jetty, piling, groin, boardwalk or pipeline above, on or below lands under waters within the State's jurisdiction, the lien shall be on the improvements together with the contracting owner's interest in the lots of land in front of or upon which the improvements are constructed and any interest of the contracting owner of the land in the land or waters in front of the land;

b. removal of a building structure or part of a building or structure and its relocation on other land, the lien shall be on the contracting owner's interest in the improved real property on which the building or structure has been relocated;

c. Excavation, drainage, dredging, landfill, irrigation work, construction of banks, making of channels, grading, filling, landscaping or the planting of any shrubs, trees or other nursery products, the lien shall be on the land to which the improvements are made, and shall not be upon the adjoining lands directly or indirectly benefitted from the improvements."

3. <u>Filing Requirements</u>

The requirements for filing a lien are as follows:

1. Construction liens may not be filed more than 90 days after the completion of the work, services, material or equipment has been provided to the project for which payment is claimed.

2. The lien must be signed, acknowledged and verified by the oath of the claimant and in the case of a partnership or corporation, a partner or a duly authorized officer filed with the County Clerk in which the project is situated.

3. A copy of the lien must be served on the owner and, if any, the contractor and the subcontractor against whom the claim is asserted within ten (10) business days following the filing of a lien. The lien claimant shall by personal service or registered or certified mail/return receipt requested, postage prepaid serve or mail a copy of the lien to the last known business address or place of residence of the owner, and if any, of the contractor and subcontractor against whom the lien is asserted (service of the lien in the manner prescribed is a condition precedent to enforcement of the lien). Section 2A:44A-9 further provides that the amount of the lien shall be limited to the contract price or any unpaid portion thereof whichever is less for the work services, materials and equipment provided.

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COMBATING WORKPLACE DISCRIMINATION CLAIMS

By Michael S. Zetlin, Esq.

It appears that with increasing frequency employers are being forced to defend workplace discrimination claims. While many of these claims may have some legitimacy, a significant portion are brought by disgruntled employees seeking vengeance against an employer or a substantial unearned severance package. Combating these claims and protecting the firm against these lawsuits, particularly the frivolous ones, requires renewed diligence on the part of employers as well as implementing certain safeguards.

The Discrimination Claim

Title VII of the Civil Rights Act of 1964, as amended by Congress on several occasions, prohibits employment discrimination on the basis of "race, color, religion, sex or national origin" by employers and other organizations and agencies. Employment discrimination is broadly defined to cover all areas of the employer-employee relationship, from hiring through termination. The Age Discrimination in Employment Act ("ADEA") prohibits discrimination based on age. It protects individuals who are at least forty years old. Most states have also enacted laws to promote fair employment.

The penalties for violating Title VII can be severe. Victims of discrimination may be entitled to compensatory damages for future pecuniary losses, emotional pain, suffering, mental anguish and loss of enjoyment of life. Reinstatement and back pay may also be appropriate remedies. Employers may also be subjected to punitive damages when acting with "malice" or "reckless disregard" of the employee's protected rights.

To seek the protection of Title VII or the ADEA, the employee must establish that the motivation for his or her termination was a discriminatory reason. Title VII, as amended by the Civil Rights Act of 1991, provides that liability is established whenever "the complaining party demonstrates that race, color, religion, sex, or national origin was a motivating factor for any employment decision, even though other factors also motivated the practice."

Defending Against the Discrimination Claim

When faced with a discrimination lawsuit, the employer will be required (with few exceptions) to demonstrate a non-discriminatory reason for the alleged discrimination. For example, in *McDonald v. Santa Fe Trail Transp. Co.*, a case that reached the Supreme Court of the United States, an employer discharged a caucasian worker allegedly for theft. The employee claimed race discrimination and cited in support of his claim that an African-American employee who was equally guilty of theft was not discharged. Unequal discipline according to the Court, does not amount to discrimination. The test is whether the action (unequal discipline in the *McDonald* case) is predicated on discrimination motives.

In another case to reach the Supreme Court, *St. Mary's Honor Center v. Hicks*, an employer demoted then discharged a correctional officer who had a commendable employment record. The officer alleged racial discrimination and argued that other employees guilty of the same violations were not subjected to such severe action. The Court found that personal animosity rather than discriminatory reasons may have motivated the action. Discharge for personal animosity is not a discriminatory employment practice, and, therefore, would not impose liability upon an employer for violation of Title VII.

Guarding Against Discrimination Claims

Employers who wish to guard against discrimination claims or other suits by disgruntled employees can take several precautionary measures. For example, an employer would be wise to document criticisms of an employee's performance through a series of written evaluations or reports which are shown to the employee before any termination occurs. The employee is thus afforded an opportunity to improve his or her performance and is much less likely to claim that the employer never provided any notice of the problem.

Another action an employer may take is to have a discharged employee sign a waiver of any rights or claims. For example, the employer may offer a more generous severance package (e.g., two extra weeks of severance) in return for a waiver. Care must be taken in drafting these waivers. Under the ADEA, for example, a waiver, among other things, must be voluntary, written in an understandable manner for the employee, specifically refer to the employee's rights under the Act, and satisfy certain time requirements.

Of course, procedures should be implemented in the workplace to avoid any discriminatory practices. Policy manuals of firms should also be drafted carefully to avoid furnishing employees with additional rights than are provided by law unless it is the employer's specific intent to do so. The policy manual can be construed as conditions of employment for the firm.

These precautions and others that may be appropriate for your firm, should be considered to ward off and assist in defending against discrimination claims.

USING EMPLOYEE MANUALS TO ACCOMPLISH FIRM GOALS

By: Carol J. Patterson, Esq.

Most firms have a personnel manual or guidebook which acquaints employees with office policies and procedures. For new employees, the manual may be the first formal introduction to the firm's requirements on a host of issues such as working hours, payroll practices, and benefits. Often the booklet is put in a drawer and forgotten until a problem arises. A manual which has been developed to address the firm's special concerns can be an effective tool in preventing or solving future problems.

For most employers, it is important to maintain the flexibility to promptly respond to changing business conditions. In a thriving economy when work is plentiful, profits are high, and talented employees are scarce, an employer may implement a generous benefits program. This can be a powerful force building employee satisfaction and loyalty. Unfortunately, such a program can become a costly liability if economic pressures change and force a retrenchment. Many design firms have experienced this shift in the recession over the past few years. Implementation of cost-saving changes has become an unwelcome necessity. In most jurisdictions, the firm's personnel manual can make this process easier for an employer by clearly indicating that the firm reserves the right to change the terms and conditions of employment. The manual can expressly provide that continuation of benefits is not guaranteed. Most employees recognize that today's competitive environment forces the firm to periodically reassess policies and expenses.

Similarly, firm management should consider the purpose of the personnel manual. In some states, courts have ruled that a personnel handbook can be construed as a contract of employment. To avoid misunderstandings regarding the purpose and function of the handbook, a firm can include language which expressly advises employees that it is provided solely for purposes of information and reference and that it is not a contract of employment. Such provisions will enable the firm to periodically review its personnel policies and make revisions as conditions warrant. This will not ease the morale problem associated with such modifications, but it can remove a potentially serious obstacle to change.

One of the most difficult issues in employee relations is separations. If an employee leaves voluntarily, the firm's key concern is having sufficient notice to hire and train a replacement. A contentious situation is more likely to arise when the firm initiates the separation. A personnel manual which simply provides that employment can be terminated "for cause" may limit an employer's options. Each decision to fire or lay off an individual may be subject to challenge on the grounds that the employer has not established "cause" for termination as required by the personnel manual.

The employer may have even fewer options if the manual goes further and itemizes the types of conduct which are the sole grounds for termination. An employee contesting the firm's decision may successfully contend that his or her termination was not based on one of the permitted causes and was therefore improper. Although a personnel manual may properly identify certain types of conduct as grounds for termination, it should not offer what appears to be an all-inclusive list. If the preservation of substantial latitude in making personnel decisions is important to the firm, the personnel manual can provide that employment is on an "at will" basis and can be terminated at any time by either the employee or the employer. In many cases, this language can enable the employer to make staff reductions without entering into lengthy discussions regarding the deficiencies of employee performance.

A special concern of design firms is moonlighting. Many design professionals have the drive and initiative to undertake work outside the office. This not only helps them to develop their skills in design and client management, but it provides a welcome supplement to their income. Many design firms recognize these benefits and allow employees to undertake such work. If work on such outside projects is not prohibited, it is important to set rules to protect the firm from unintended assumption of additional liabilities. The personnel manual can accomplish this by advising employees to inform their own clients that they are performing these services on their own, not as an employee of the firm. It is critical that employees and their clients know that the firm's insurance is not available to cover claims in connection with this work. The work should not be done using office facilities.

Finally, do not ignore the basics. The personnel manual can be an excellent means of communicating to employees many of the firm's requirements. These are a few examples:

- Specify standard working hours and emphasize the need for punctuality if it is important for the firm's operations.

- Describe the firm's policies regarding absences. The standard issues are sick leave, vacation days and holidays. Many firms also set policies for personal days, jury duty, national guard or reserve service, disability, and leaves of absence.

- Outline procedures for overtime work. Employees who are eligible for overtime pay should have a clear understanding of the threshold separating straight time from overtime. Requiring advance written approval of all overtime work can maintain management control over overtime expense.

The firm should evaluate this check list in light of its own needs. It can be valuable to review the manual on an annual basis to confirm that its provisions are consistent with current policies and to consider whether problems which arose during the prior year indicate that new changes should be made. For example, a firm which had an unsuccessful experience with two new employees may want to consider adding a provision that all employees have probationary status for a specified period. This process of fine tuning will allow the firm to benefit from experience and avoid repeating mistakes.

A STATUTE OF REPOSE FOR NEW YORK: THE TIME IS NOW

By: Raymond T. Mellon, Esq.

While New York has traditionally been in the vanguard of legal development, the Empire State is woefully behind the times in failing to enact a Statute of Repose for design professionals. Incredibly, New York is one of only two states that have failed to provide such protection. This long overdue relief would protect design professionals from frivolous lawsuits that assert tenuous claims arising from projects completed years ago.

The purpose of a Statute of Repose is to prohibit the commencement of lawsuits a specified number of years after completion of the conduct in question. In regard to design professionals, a Statute of Repose would bar third-party lawsuits for personal injuries based upon claims of errors and omissions in the design of a project after the expiration of a stated time period. Design professionals already have adequate protection against untimely lawsuits brought by client/owners or contractors through the New York Statute of Limitation of three years for negligence claims and six years for contractual claims. Unfortunately, the three year limitation for negligence claims asserted by injured third-parties does not begin to run until the injury occurs, without regard to the year of completion of the project. This scenario places a Sword of

Damocles over design professionals who are compelled to continue insurance coverage, sometimes into their retirement, for projects completed decades before.

Leaving aside the obvious economic cost of continuing insurance coverage for years or decades after completion of projects, a design professional suffers a severe disadvantage when joined as a defendant in a third-party personal injury action occurring years after completion of the project. At that point, the design professional's contact with the project ended years before, and in the intervening years the owner had the obligation to maintain and repair the project. Often times, the owner has made modifications to the project, or has failed to repair and maintain the building conditions, conduct that can directly impact upon a design professional's liability. This raises a central issue of whether the negligence alleged is attributable to design or maintenance failures. After passage of sufficient time, design defects are subsumed by maintenance and repair defects. The owner, as the recipient of continued benefits from ownership of the project, is in the best position to insure the public's safety.

These obvious facts have caused the legislatures of 48 states to enact Statutes of Repose that protect, at a minimum, design professionals. The coverage afforded by these Statutes of Repose varies greatly, some limited solely to architects and engineers (e.g., Connecticut), while others offer expansive coverage which also protects contractors, subcontractors and materialmen (e.g., Rhode Island). The time period for the application the Statute of Repose similarly varies from state to state. Tennessee's Statute of Repose applies 4 years after substantial completion of the Project, while in Iowa a design professional has potential liability up to 15 years from the date that the act or conduct occurred.

Some states, such as California, have recognized the distinction between patent and latent design defects, and provide an extended period before the protection is applied to claims arising from latent design defects. This bifurcation of protection recognizes that latent design defects are inherently difficult, if not impossible, to ascertain upon reasonable inspection. Even with latent design defects, these Statutes of Repose acknowledge that after an extended period a design professional should be protected from claims arising from long-completed projects.

While the need for a New York Statute of Repose for design professionals is beyond question, one salient observation must be made. Relevant data from one insurance company providing coverage to design professionals suggests that the incidence of third-party claims constitutes a small percentage of the total claims made against design professionals. In terms of the dollar value of such claims, the impact is even smaller. The vast majority of lawsuits brought against design professionals relate to project claims, comprised of worker injuries and owners' claims of errors and omissions on the project. This is not meant to minimize the obvious impact of a third-party personal injury lawsuit against a design professional. Instead, these facts simply establish that design professional's greatest risk of liability is from the client and project workers.

While the states are almost uniform in affording design professions some modicum of protection against claims arising after a statutory time period, New York has stubbornly refused to recognize this trend. Despite repeated attempts by a number of legislators, the proposed statutes submitted annually in the New York Assembly languish in committees. Unfortunately, the strongest lobby against passage of a Statute of Repose is the personal injury bar of trial attorneys that represent plaintiffs. Despite admirable efforts by the many Chapters of the New York State AIA, design professionals have not yet sufficiently combined to form a lobby that can effectively pressure legislators to enact of a Statute of Repose. One possible avenue for increased lobbying pressure would be to seek passage of a statute that includes within its scope contractors, subcontractors, and materialmen. The increased resources that the building industry could infuse into the legislative lobbying effort may provide the needed pressure to finally enact a New York Statute of Repose.

A Primer on Ownership Transition -- Part One -- Management Transition

By Michael K. De Chiara, Esq.

When the principals in professional design and construction firms reach a certain age, they invariably begin to wonder how they can realize a return of their portion of the firm's equity. The better prepared principals reach that certain age in their mid-fifties and allow sufficient time to organize and plan their equity and management transition, the lesser prepared principals begin addressing these issues in their middle sixties and generally have less successful transitions.

In some older, well-run firms, there is a long-established procedure for existing principals to convey their equity back to the firm itself or to younger principals as they concurrently relinquish management control to the next generation. In such firms, there is an established method for valuing the equity of a principal and paying for such equity as the principal "transitions" out of the firm and younger principals take his or her place.

However, many of today's most successful engineering, architectural, design and construction firms were formed over the last twenty to thirty years and the principals are just now beginning to address the issue of how they will "transition" out of their firms or companies. The process of change of ownership in closely held professional and construction firms is generally referred as "ownership transition." There are two broad and related categories that must be recognized and planned for in order for the ownership transition process to be successful and for firms or companies to survive into the second generation. The two areas are: (1) transition of management; and (2) transfer of and payment for equity interests. Each area is critical to ownership transition and each is dependent on the other. This article will address some issues affecting management transition. Part Two of this two-part article, which will appear in the next issue of the Zetlin & De Chiara Quarterly Review, will address transfer of equity interests.

Transition of Management

In order for any ownership transition to be successful, it is axiomatic that there must be a successful management transition as well as a successful equity transition. Often, the payout of the retiring or withdrawing principals equity in a firm or company is dependant on the revenue and profits generated by the firm after the retiring or withdrawing principals leave and their control of the management of the firm ceases. This typically occurs in professional firms where younger principals pay for the equity of the older principals through a disportionate diversion of firm revenue to the older principals for an agreed period of time. In this situation, the ability of the retiring or withdrawing partners to realize the full return on their equity is dependant on the ability of the succeeding partners to manage the on-going entity and continue to generate substantial revenue.

Management of professional design and construction firms can be broken into three general areas: (a) -- Marketing -- to sustain current business and to obtain further work; (b) -- Technical Supervision -- to ensure that the quality of the professional services rendered or the work performed for clients is always excellent; and (c) -- Internal Administration -- to ensure that the business of running the firm itself is properly managed. Typically, different individuals have strengths and weaknesses in one, sometimes in two of these categories. It is very rare to find a professional who excels at all three. Therefore, in planning for the proper management transition of a firm, the current principals must identify those individuals within the firm who have the talents and/or dispositions required to meet one or more of the three areas of management and begin, as early as possible, to give those individuals responsibility in those areas where their talents lie. The prevalent view today in business is that it takes between five and ten years to develop good management skills in professional business managers. The timing required to develop managers for professional and construction firms is probably similar. Thus, the sooner you begin to give younger employees real management responsibility, the more time they will have to grow into the roles you ultimately want them to fill. Sometimes, the individuals you have assumed will fill certain roles end up not meeting your expectations. Better to find that out earlier rather than later so that alternate successors can be identified and groomed.

The keys to successful management involve the smooth coordination of the three management areas--marketing, technical supervision and internal administration. How different firms emphasize each of these areas and how it rewards the relative contributions from each area goes a long way towards defining the firm.

Summer 1995

A Primer on Ownership Transition --

Part Two -- Equity Transition

By: Michael K. De Chiara, Esq.

This is Part II of a two part article on Ownership Transition. This portion of the article deals with transfer of equity interests.

Equity Transfer

Transfer of management was discussed in my prior article as half of the Ownership transition process. The other half of the ownership transition process is the transfer of equity interests. Equity transfer raises two basic issues. Where will the capital come from to finance the equity purchases? What time frame will be required to complete the payout for the equity interests? In addressing these two basic questions, there are limitless combinations of payout schemes which can be adopted for particular situations, most of which are timing and tax driven. However, the sooner the issue of ownership transition is addressed in a firm, the less important timing issues become and the more rational the process invariably becomes.

The realty of equity transfer, for most professional and construction firms, comes down to a choice between one of two basic schemes for funding the equity transfers: (1) using internally generated capital to finance the equity transfers (i.e., the money to finance the purchase of the equity of the retiring or withdrawing partners comes from the firm itself), or (2) using externally generated capital to finance the equity transfers (i.e., the succeeding principals go to outside sources such as banks, personal savings, or relatives to finance the purchase). Again, while there are numerous permutations and buy-out schemes that can be adopted to meet the requirements or preferences of any situation, they all flow from some combination of these two basic revenues: internally generated capital or externally generated capital.

From the retiring or withdrawing principal's perspective, it is generally better to have their equity paid for with external capital. Use of external capital usually permits the entire purchase to be consummated on an earlier and certain date. Any uncertainty concerning future payments disappears. And the burden of financing the equity purchases shifts fully onto the shoulders of the succeeding principals. The main advantage for the succeeding principals in this scenario, however, is they now have the unfettered ability to run the firm without interference from the retired or withdrawing principals (who have been paid in full). However, that freedom usually has a price, the succeeding principals typically are left with sole liability to pay for the debt they incurred (usually recourse debt) in accessing external capital.

Of course, from the self-interest of the succeeding principals looking to acquire equity and assume management of a firm, just the opposite situation is to their best advantage. That is, they would prefer to finance their acquisition of the equity of the retiring or withdrawing principals with internally generated revenue (that is, revenue generated by the firm itself). This structure sometimes lessens the personal liability of the succeeding principals (some ownership transitions that are paid for with internally generated revenue are on structured a non-recourse basis). However, this structure usually involves continued management involvement on the part of the retiring or withdrawing principals until they have been paid in full for their equity interests.

Conclusion

This article is intended as a very general initial introduction to ownership transition. The details of any ownership transition plan involve numerous critical legal and accounting issues and solutions which are particular to the circumstances, preferences and economics of a particular firm. Any one of the many issues typically encountered in a properly organized ownership transition could present serious legal and financial traps which the well-advised firm will avoid.

The key to a successful ownership transition is careful planning over a period of time with experienced professionals. The well-planned ownership transition converts an often confrontational and angst filled process into a well-managed exercise that enhances your business and properly rewards principals for the contributions they have made to their firms.

APPELLATE COURT IMPOSES AFFIRMATIVE DUTY UPON LANDLORDS TO INSPECT FOR HAZARDOUS LEAD PAINT CONDITIONS

By: Raymond T. Mellon, Esq.

In recent years, considerable attention has been focused upon the danger that lead paint poses to children. In response to this condition, remedial statutes have been enacted on the federal, state and local levels. New York City enacted Administrative Code § 2013h, also known as Local Law 1, to protect children from the hazards of lead paint. In Juarez v. Wavecrest Management Team Ltd., the Appellate Division, First Department, scrutinized Local Law 1 and found that the statute imposed a continuing duty upon landlords to identify and remove lead paint hazards from residential dwellings.

Recognizing that young children are most at risk from the hazards of lead paint, Local Law 1 was specifically enacted to apply to multiple dwellings in which children under seven reside. The law requires landlords to "remove or cover" any surface having a paint or coating with levels of lead in excess of fixed statutory levels. The statute further establishes a rebuttable presumption that any peeling paint found in buildings erected before 1960 contains levels of lead in excess of the statutory maximum. Finally, the existence of paint with excessive levels of lead constitutes a Class C immediately hazardous violation that must be corrected within 24 hours.

In Juarez, an infant child suffered physical injury as a result of ingesting lead based paint chips. The lower court found that the peeling paint in the apartment contained levels of lead in excess of the statutory maximum. In granting judgment to plaintiffs, the lower court also held that the defendants, the prior owner, the successor owner, and the managing agent, received prior notice of the lead condition.

On appeal, the Appellate Division extensively analyzed whether a violation of Local Law 1 creates absolute liability to the landlord without regard to negligence. The Court analyzed the purpose of the statute and the class to be protected, i.e., children under the age of seven, a class of persons unable to exercise self-protective care. Although other statutes had imposed absolute liability to protect children, the Appellate Division held that "overriding public policy reasons" militated against the imposition of absolute liability for violations of Local Law 1. While the problem of lead paint pervades New York City's housing stock, the imposition of absolute liability would require landlords both to inspect and to be absolutely successful in finding every lead paint hazard in their buildings. Under such a standard, a diligent landlord unable to find all lead paint conditions, after exhaustive searches, would be liable notwithstanding any possible defense. The Appellate Division held that such an outcome would be "draconian."

In place of the absolute liability rule, the Appellate Division held that a violation of Local Law 1 constituted negligence as a matter of law. Under such a standard proof, applicable defenses could be proffered by the landlord. Therefore, the Court's rejection of the absolute liability standard leaves open the possibility that a landlord could establish that lead paint existed in the building even though all reasonable and prudent efforts were made to discovery the condition.

Contrary to the lower court's holding, the Appellate Division rejected the requirement of prior notice to a landlord and, instead, held that Local Law 1 imposes an affirmative duty upon landlords to inspect their residential dwelling to ensure that no hazardous lead paint condition exists. This duty is continuing and not satisfied by a single inspection conducted when the building was purchased. In rejecting a prior notice requirement, the Court found that Local Law 1 unambiguously imposed upon landlords the burden of identifying and removing such conditions. The requirement of prior notice of the condition would serve as incentive for landlords to remain ignorant of the lead paint condition. Thus, remedial action would only occur after notice was received, which notice would probably be obtained as a result of an incident of lead poisoning. Consequently, the Court found that only an affirmative and continuing duty to inspect would ensure a landlord's compliance with Local Law 1.

As a result of the Juarez decision, landlords must now diligently inspect their buildings to ascertain the existence of lead paint conditions. The obvious consequence of the Appellate Division's decision will be an increase in the cost of maintaining and operating multiple dwellings in New York City. However, inspection costs must be balanced against the enormous liability that may arise from a judgment granted to a child suffering from lead poisoning. To avoid such liability, landlords must promptly institute inspection procedures, conducted by qualified technicians, to discover all lead paint conditions in their buildings.

STAGE SET FOR CROSS-BORDER LICENSING OF ENGINEERS, BUT HURDLES REMAIN

By: Brian Fleischer
Summer Associate

Thanks to an historic agreement among engineers from the United States, Canada and Mexico on cross-border licensing requirements under the NAFTA, United States engineers may soon be able to practice anywhere from the Yukon to the Yucatan. It is, however, a bit premature to start booking your international flights just yet.

The agreement, known as the Mutual Recognition Document (MRD), designed to increase engineers' mobility in the North American market, must now be ratified by each country's professional engineering organizations. These organizations, leaders of which were responsible for creating the MRD, could ratify the agreement before the end of the year, despite the opposition of the engineering boards of several U.S. States, most notably California.

However, the MRD is not legally binding, and it will mean next to nothing if it is not implemented into the licensing laws of the individual U.S. and Mexican States and Canadian provinces. Cross-border licensing under the terms of the MRD will be possible only in those jurisdictions which implement the agreement into their laws.

If these hurdles are passed and the terms of the MRD are widely implemented in the three nations, interjurisdictional licensing will work as follows. An engineer who is licensed in her "home jurisdiction" may apply for a temporary license in the "host jurisdiction", which would allow her to practice in the host jurisdiction for either three years or the duration of a specific project. In the third year, the temporary license holder may apply for a regular license. Unless specifically required by the host jurisdiction, neither the temporary nor the regular licensing process will require the applicant to take an examination. Neither will the applicant be required to maintain a representative office or be a resident in the host jurisdiction.

However, the MRD sets forth strict guidelines as to who will be permitted to obtain a temporary license. Applicants licensed in their own country who have graduated from an accredited engineering program must have at least twelve years of acceptable engineering experience and eight years of licensed practice, must demonstrate an ability to communicate in the language of the host jurisdiction and must demonstrate knowledge of the regulations governing the practice of engineering in the host jurisdiction. A licensed engineer who did not graduate from an accredited engineering program must satisfy the same requirements for a temporary license, except she must have at least sixteen years of engineering experience and twelve years of licensed practice. The requirements set forth in the MRD were designed to take the place of examinations, which currently are the cornerstone of the licensing process in almost all jurisdictions within the three nations. Eliminating the examinations should cut down on the time required to obtain a license to practice in another jurisdiction, and would shift the emphasis of cross-licensing to experience.

The MRD states that nothing in the agreement will preclude any individual from pursuing licensure in any foreign or domestic jurisdiction through existing procedures. Widespread implementation of the MRD procedures, if it occurs at all, will probably take at least a few years. However, cross-border licensing will almost certainly be facilitated in the near future, and as Mexico continues to build its infrastructure, foresightful American engineers may find exciting opportunities south of the border.

HARD CASES MAKE BAD LAW: DESIGN PROFESSIONALS AND SITE SAFETY

By: Carol J. Patterson, Esq.

A recent decision by a New Jersey appellate court raises new issues concerning design professionals' responsibility for site safety in that state. Desiring to provide a remedy to the family of a construction worker who was killed when a trench collapsed at a sewer construction site, the court in *Carvalho v. Toll Brothers & Developers* concluded that an "engineer may be subject to liability if its failure to exercise reasonable care under the circumstances increases the risk of harm to a third person." An examination of the facts in *Carvalho* suggests that the court's decision is not a broad a change as it appears to be; but it is likely to increase the uncertainty for design professionals regarding the scope of their responsibility and liability for accidents which occur on the job site.

The *Carvalho* court recognized that there was no New Jersey case law which mandated the result it reached. In fact, the court's own prior ruling in *Sykes v. Propane Power Corp.* supported the engineer's contention that it had no liability to plaintiff. Under the applicable project agreements, the engineer was not responsible for site safety. The engineer provided full-time site observation services to "ensure" that the contractor's work was performed in accordance with the plans and specifications. Although the engineer had authority to demand improvement in the contractor's work and rate of progress, in so doing it did not relieve the contractor of its sole responsibility for the construction means, methods and techniques of executing its work. The agreement expressly provided that the engineer did not have responsibility for such means and methods or for safety precautions used by the contractor on the project. In sum, the contract had standard provisions allocating oversight responsibility to the party doing the work. Based on this contractual allocation of responsibilities, the engineer argued that it had no obligation to direct the contractor's activities with respect to safety. The trial court agreed and granted the engineer's motion for summary judgment.

The appellate court reversed, emphasizing the facts indicating that the engineer's site representative was well aware of the risk faced by deceased worker. He was present at the site when the accident occurred, and he was aware that there were no trench boxes used on site on the date of the accident, even though he also knew that it was common to use trench boxes to protect workers from collapse injuries. Most significantly, he also knew that the trench had collapsed several times before the accident. In fact, one week before the accident, he had noted that the trench was unstable, that water had pooled at the bottom of it, and that walls caved in to the floor. In sum, there was substantial evidence that over an extended period of time, the engineer in *Carvalho* had knowledge of the dangerous condition and took no steps to correct it or advise the owner or contractor to do so.

In light of these facts, the appellate court essentially determined as a matter of policy that the engineer had a duty to "take some reasonable action to prevent injury" to workers in the trench. The court reached this conclusion despite the fact that the engineer, the owner, and the contractor had negotiated and entered into separate agreements and acted in accordance with their terms. The court essentially revised the parties' agreement by assigning to the engineer a responsibility that it has not assumed. The court also ignored the fact that the parties' allocation of responsibility for site safety to the contractor makes sense. The contractor is in the best position to implement an effective safety program through training and supervision of staff ranging from the top project supervisory personnel to the foremen working with individual work crews. The possibility that this responsibility can be shared with other parties may weaken what is otherwise a strong incentive motivating the contractor to maintain a safe workplace.

By contrast, a project engineer does not have direct control over the contractor's personnel. Design professionals typically do not have responsibility or authority to direct contractors' work with respect to the means and methods of construction or safety issues. Faced with a compelling series of facts, the court determined that as a matter of public policy it was appropriate to ignore the parties' agreement and impose liability on the engineer.

Accordingly, *Carvalho* creates some uncertainty regarding design professionals' responsibility for site safety. Design professionals could find themselves caught in a dilemma between adhering to the terms of their contractual relationships and general legal principles which impose a liability apart from the terms of a written agreement. The result in this case demonstrates the tension between the important goal of maintaining a safe workplace and the practical need to allocate specific functions to various members of the project team so that the work can be carried out efficiently.

It is important to recognize that *Carvalho* does not transform design professionals into safety supervisors who patrol the job site looking for unsafe conditions. It is by no means clear that the court would have reached the same conclusion if the engineer's site representative had not repeatedly observed the unsafe condition which ultimately resulted in a fatality. On the contrary, it seems likely that absent evidence of the engineer's actual knowledge of the potential danger, the court would have been reluctant to disregard the project agreements and impose a new responsibility on the engineer. In future cases, New Jersey courts will have to determine the proper balance between the terms of a negotiated agreement and the policy analysis which was the key to the *Carvalho* decision.

Structuring a Successful Joint Venture for a Design Build Project

By: Michael S. Zetlin, Esq.

The trend towards design build is continuing. In the public and private sectors owners are turning to the perceived advantages of the "single point of responsibility" offered by the design-build process. Some projections have indicated that over the next few years, design-build may be used on over fifty percent of significant construction projects.

This trend is requiring contractors and design professionals to form strategic alliances in pursuing projects. In many instances, these alliances result in contractors assuming the responsibilities of the design for the project and then turning to design professionals to perform traditional architectural and engineering functions. In other instances, the design professional and contractor structure a joint venture which becomes the design-build entity. The appropriate legal structure for any project will be governed by the relationship between the design professional and contractor, their respective bargaining strength and other factors such as state licensing requirements which may prohibit the design professional from serving in a subordinate role to a contractor.

With any structure, however, design professionals and contractors will find themselves assuming risks to which they are unaccustomed. For example, design professionals may find that they are responsible for the safety program for the project. They may also have responsibility for developing detailed budgets, and for sharing the risk for construction cost overruns. Design professionals also will feel more pressure than usual to cut costs and increase profit margins, sacrificing quality along the way. No longer is the design professional the owner's protector. Rather, the design professional views the contractor as the client or as a business partner. Even the American Institute of Architects recognizes this change of the design professional's role. In its B901 Agreement, the AIA provides in paragraph 2.1.1:

> The professional obligations of the Architect are undertaken and performed in the interest of the Design/Builder . . . . All communications between the Architect and the Owner or Contractor shall pass through the Design/Builder unless otherwise directed by the Design/Builder.

Likewise, the contractor, as the design-builder or a joint venturer of the design-builder, assumes direct responsibility to the owner for schematic design, design development, and construction documents. The contractor also shares in the risk for design errors. Design errors traditionally required owners to pay contractors for extra work. In a design-build setting, the owner escapes responsibility for the error and the contractor is forced to turn to its design professional partner for compensation for the error which, from a business perspective, may not be feasible.

To meet the challenges of design-build, the contractor and design professional must consider and resolve as many business and legal issues at the earliest opportunity. Some of these issues are project specific. Many will be recurring depending on the nature of the work and the parties included. For example, the parties have to determine whether the design professional has any control over construction decisions (since the design professional may be sharing in the profits and losses for the project).

Several trade organizations -- The American Institute of Architects, The Associated General Contractors of America and, most recently, The Engineers Joint Contract Documents Committee -- have developed forms for design-build projects. Needless to say, each of the forms offer certain advantages, depending on the perspective of the particular party. These forms should be used as a guide for identifying issues that should be addressed when venturing into a design-build project.

Sophisticated and smart construction and design firms have already developed or are in the process of developing their design-build strategy. It is inevitable that design-build will cross your path in the future. Take the time now to develop alliances and think through the role your firm will play when the design-build opportunity comes your way. When the opportunity arrives, devote the effort immediately to structure a successful relationship.

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Cooperatives and Condominiums Required to Provide Reasonable Accommodations to Disabled Residents

By Raymond T. Mellon, Esq.

In a decision applicable to many cooperatives and condominiums in New York City, the Appellate Division, Second Department, has determined that a cooperative's refusal to expend funds to install a wheelchair ramp for a disabled resident constitutes a violation of the Federal Fair Housing Act and the New York City Human Rights Law. The holding in *Matter of United Veterans Mutual Housing No. 2 Corp.* imposes a broad responsibility upon cooperatives and condominiums to ensure that their fiscal policies are not violative of applicable statutes protecting the disabled.

The *United Veterans'* dispute concerned a wheelchair confined resident and a cooperative of thirty-nine garden apartment buildings containing 800 apartments. For ten years the disabled resident was provided access to her apartment through use of a wooden ramp. After the ramp deteriorated, the cooperative refused to expend funds to construct a replacement ramp, but agreed that a new ramp could be installed at the disabled resident's expense. After installation, the disabled resident filed a complaint with the New York City Commission on Human Rights contending that the cooperative was engaging in unlawful discriminatory practices.

In denying the discrimination allegations, the cooperative claimed that the ramp was not in compliance with the Building Code and inconvenienced an elderly resident in the same building. It further claimed that requiring the disabled resident to obtain the ramp at her own expense did not constitute a discriminatory practice.

The cooperative and the disabled resident subsequently entered into a settlement agreement pursuant to which the cooperative agreed to construct a new ramp at its own expense. However, the cooperative emphatically reaffirmed its overall policy of refusing to make any expenditures to provide reasonable accommodations for disabled residents. The Human Rights Commissioner then issued a decision holding that the cooperative's policy of outright refusal to provide any reasonable accommodations to common elements which would address the needs of disabled residents, regardless of cost, violated the Human Rights Law. The Commissioner ordered that the cooperative (i) cease and desist its policy of refusing to expend funds to provide reasonable accommodations to disabled residents, and (ii) establish a new policy, in compliance with the New York City Human Rights Law, which individually evaluates all requests by disabled residents for accommodations or improvements that do not impose undue hardship.

The cooperative subsequently sought an order from the Queens County Supreme Court to have the Commissioner's determination set aside. The cooperative's arguments were rejected as moot because a 1991 amendment to the New York City Human Rights Law imposed an affirmative obligation to make reasonable accommodations for the disabled. (The law's legislative history explicitly cited the Commissioner's decision in *United Veterans* as a basis for the amendment.) The trial court reviewed the administrative hearing record and determined that the cooperative's admitted refusal to expend funds to accommodate the needs of the disabled clearly supported the Commissioner's determination.

On appeal, the cooperative argued that the Commissioner's interpretation violated due process because it required all other cooperative residents to pay for improvements that will only benefit a disabled resident. The cooperative further argued that its policy of allowing disabled residents to make improvements at their own expense was in conformity with the Federal Fair Housing Act, which it claimed had provided the governing definition of the term "reasonable accommodation" as it applied to a disabled person. The cooperative alleged that any law containing a contrary or more expansive construction of that term is preempted by the federal law.

In affirming the trial court's judgment enforcing the Commissioner's determination, the Appellate Court rejected the cooperative's argument concerning federal and state law, which were held not to be in conflict. Since both laws prohibited the refusal to make reasonable accommodations that would afford a disabled person equal opportunity to use a dwelling unit, the cooperative's policy violated both the Federal Fair Housing Act and the New York City Human Rights Law. Finally, the Appellate Division held that requiring cooperative residents to expend funds that solely benefit a disabled resident did not constitute a due process violation. The legislation under review had the purpose of preventing discrimination and protecting the disabled, thereby promoting the general welfare of the community. The Court held that legislation promoting the general welfare commonly benefits some individuals more than others.

The *United Veterans* decision heralds a new era for cooperatives and condominiums in identifying and addressing the needs of disabled residents. Particular attention will now have to be given to individual requests for "reasonable accommodations" that concern the needs of disabled residents. Since the cost of the improvement in *United Veterans* was minimal, the issue of a disabled resident's request for an accommodation that constitutes an undue burden upon the cooperative or condominium was not addressed. Clearly, an improvement which is prohibitive in cost and threatens to deplete reserves is not a reasonable accommodation. In these financially constrained times, identifying the area between "reasonable accommodation" and "undue burden" will place additional pressures upon board members. Guidance will ultimately come from future cases containing facts less extreme than *United Veterans*. In the interim, cooperatives and condominiums will have to determine carefully what improvements can be made, and at what cost. A careless mistake could result in a discrimination claim being filed under the Human Rights Law.

Expanding The Tent: Successfully Bringing New Owners Into The Firm

By Carol J. Patterson, Esq.

A successful business is one that effectively adapts to changing circumstances. As a firm grows, its owners and top managers must consider enlarging the leadership tier. This may be necessary for a number of reasons. More leaders may be required to serve the firm's clients. Alternatively, they may be needed to increase the client base to ensure the firm's survival. New leaders may be the key to establishing the business as an enduring institution which continues after the retirement of the management team that founded it.

It is possible to hire talented managers and marketers who can perform these functions. For large enterprises, this is the norm. But firms with a small ownership group may find that compensation is not enough to satisfy the talented individuals that they want to retain or attract. A number of gifted design professionals want to establish and manage their own firms -- or at least share ownership and management responsibilities. These entrepreneurial individuals may have a great deal to offer, provided that the current owners are able to smoothly adjust to the expansion.

The addition of new partners or shareholders, whether accomplished by promotion from within the firm or by seeking talent from outside, is a decision which merits careful consideration in light of the personal and business goals of the owners of firm and the person who is to join them. Once the parties have reached an agreement on the basic issue of their willingness to work together as co-owners, they must address the specific terms of their agreement.

A key issue which must be resolved is the percentage of ownership to be transferred. The parties should also consider whether this ownership share shall be increased over time. If so, by how much and on what terms. The flip side of this issue is how the new owner will pay the firm for his or her newly acquired shares or partnership interest. Many long term employees expect that the owners of the firm will give them a portion of the firm in consideration for their years of loyal and valuable service. Gratuitous transfers are by no means typical. Having devoted tremendous time and energy to building a successful business, most owners expect that newcomers will compensate them for their effort.

The amount of such compensation will be the subject of negotiation and depend on a number of factors such as the parties' respective evaluations of the value of the firm and the purchaser's potential contribution to its prosperity over time. If the prospective purchaser does not have the resources to pay a purchase price which is mutually accepted as fair, the parties will need to be creative and develop a framework for extending payment obligations over time and funding them, at least in part, with the purchaser's future earnings and profit share.

Once the parties have reached agreement on the central terms of the deal, the size ownership share to be transferred, the purchase price and payment mechanism, they must address a number of other issues which are essential to avoid future misunderstandings and properly allocate their mutual responsibilities. The agreement should accomplish the following:

4. It should clarify the parties' obligations to devote time to the firm. If a full-time professional commitment is required, the agreement should say so. Some firms establish minimum standards for hours spent on firm business. It should not come as a surprise if any party intends to spend a portion of his time on another venture; disputes and disappointment are likely to result.

5. The parties' understanding regarding day-to-day management of the firm must be confirmed. The new purchaser should know whether the founders or majority owners are retaining management control of the firm. The agreement may provide whether certain issues require unanimous consent or an especially large majority vote.

6. The central monetary issues must be the agreement must not only provide for the parties' sharing of profits and losses, but it should also address their obligation, if any, to make additional capital contributions from time to time.

7. The agreement should also address whether any or all of the owners are entitled to a salary or other fixed payments. In some cases, the parties will need to preserve

financial flexibility, and will leave these issues to the discretion of the managing principals. In others, individuals requiring same guaranteed level of compensation will require a commitment, perhaps in the form of a separate employment agreement.

8. The parties should confirm their understanding of what will happen if one or more owners leaves the firm. For example, if an owner becomes ill and is unable to work for an extended period of time, when can the individual (or the firm) declare that he is out on disability? How long must the firm continue to pay his salary? What are the firm's obligations to a retiring shareholder? Is there a specified age which triggers entitlement to full retirement benefits? How quickly must the firm pay an individual or his estate the value of his ownership interest in the event of the death, withdrawal or retirement? The agreement should spell out procedures to fairly balance the interests of a departing individual and the firm.

9. An issue of great concern to all owners is the possibility of admitting new owners or expelling current owners from the firm. The agreement should speak of the degree of unanimity required for this decision. Will a majority vote suffice or is unanimous consent required?

10. If the firm is concerned with protecting its intellectual property, including plans, specifications, computer programs, or proprietary commercial information relating to unique procedures or client relationships, the agreement should document the parties' understanding with respect to these matters.

The process of discussing and reaching a mutually acceptable resolution of these issues will facilitate the effective collaboration of the firm's owners. Although no agreement can either anticipate or avoid all potential disputes, an effort to address issues in advance -- when everyone is willing and eager to cooperate with each other -- can smooth the way.

Limited Liability Company Law

PART TWO: Limited Liability Companies

By Michael K. De Chiara, Esq.

In our last issue of the Zetlin & De Chiara Quarterly Review, I wrote about the new Limited Liability Partnerships ("LLP's") established under the new Limited Liability Company Law (the "Law"). This article will briefly describe the other new entity established under the Act, a Limited Liability Company (an "LLC").

Background

An LLC is a business form which combines the features of a corporation and a limited partnership. Sophisticated engineers, architects, investors and owners of business properties are well aware of the advantages of limited partnerships. Often, when a small group of investors are assembled to purchase a building, they are organized as a limited partnership with a corporate general partner (which typically owns a nominal interest in the limited partnership -- 1 or 2 percent) while the individual investors comprise the limited partners. The primary advantages of this structure have been to insulate the individual investors from personal liability while affording them a direct pass-through of profits and tax benefits. In a limited partnership, the limited partners are prohibited from involvement in the management of the limited partnership, which is typically delegated to a corporate general partner owned and operated by the limited partners. Although this arrangement appears to violate the requirements of a limited partnership (limited investors not having direct involvement in management), it has, to date, withstood legal attack.

LLC's permit its members to have the same limited liability and tax benefits as a limited partnership while allowing them to actively participate in its management.

An LLC

The LLC is formed by the filing of "articles of organization" with the New York Department of State. Unlike a corporation, the members of the LLC are allocated "interests" which are more analogous to partnership interests then the shares of stock which an investor in a corporation would receive.

The most salient feature of an LLC is the limited liability it affords its members. The Act provides that "neither a member of a limited liability company, a manager of a limited liability company managed by a manager or managers nor an agent of a limited liability company (including a person having more than one such capacity) is liable for any debts, obligations or liabilities of the limited liability company or each other, whether arising in tort, contract or otherwise, solely by reason of being such member, manager or agent or acting (or omitting to act) in such capacities or participating (as an employee, consultant, contractor or otherwise) in the conduct of the business of the limited liability company." This broad language, when combined with the expected federal tax treatment of New York LCC's and the ability of members to manage an LLC are what distinguishes this business form from both corporations and limited partnerships.

An LLC can be managed (i.e., operated day to day) by either its members or by designated managers. If the owners of an LLC want a separate class of managers to operate the entity, they must affirmatively provide for this in their articles of organization and in their operating agreement. Basically, as long a managers carry out their duties "in good faith and with that degree of care that an ordinarily prudent person in like position would use under similar circumstances" (an objective test), they will have no personal liability for their actions. Similarly, LLC's can indemnify its members and managers against all claims and demands whatsoever, provided (i) such person is not adjudged to have acted in bad faith or the acts indemnified against were the result of active or deliberate dishonesty, or (ii) such person gained a financial profit or other advantage they were not entitled to from the acts for which they seek indemnification. The above exculpations from liability only apply to ordinary business liabilities, they do not apply to claims of professional malpractice. However, with regard to professional malpractice, the LLC will afford professionals the same insulation from vicarious liability as the P.C. or the LLP as discussed in the last issue of the Z&D Quarterly.

One additional feature of an LLC is that no creditor of any member has any right to obtain possession of or exercise legal or equitable remedies with respect to the property of an LLC. Quite simply, this means that the property held by an LLC is not subject to capture by the creditors of an individual member. This is similar to a corporation where the creditor of a minority shareholder cannot force a sale of corporate assets.

The disadvantages of an LLC are basically two-fold: (1) uncertainty of federal tax status; and (2) difficulty of transferability. While the Internal Revenue Service has not yet ruled that a New York LLC would be taxed as a partnership, most tax-experts who have reviewed the law are confident that the IRS will so rule.

The advantages of an LLC are similar to those of an LLP -- limited liability for partners while at the same time permitting active management of day-to-day operations. However, for most engineers and architects, an LLP or a P.C. is the preferred form of business entity. The LLC make more sense for real estate or securities investors who are looking for an alternative to subchapter S corporations or limited partnerships.