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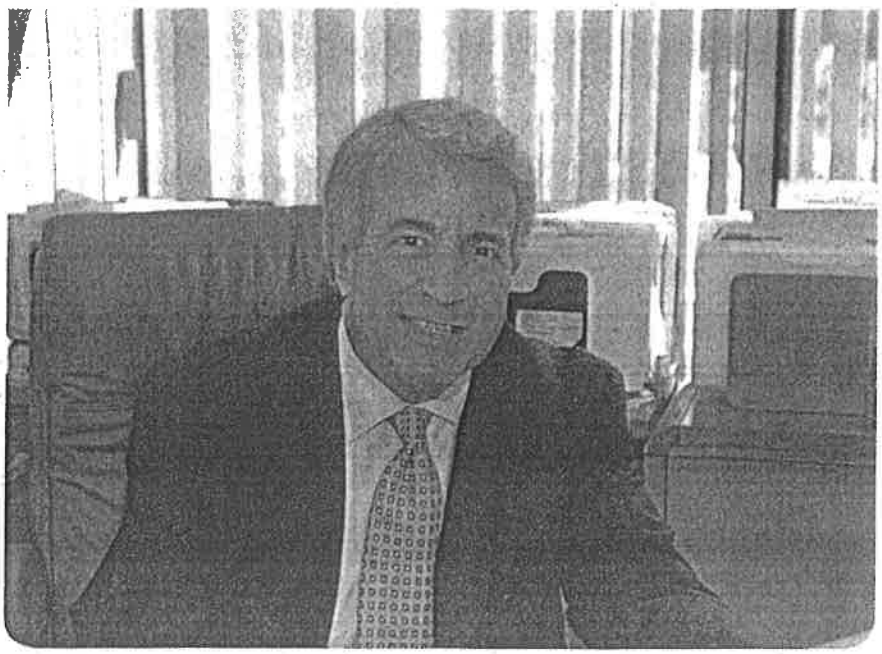
Capital Work Coping with Construction Disputes



Partner Ronald A. Sher

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ISSUE How does a board avoid a construction dispute regarding the performance of a major capital improvement project. The short answer: due diligence.

BACKSTORY The board selected an engineer to prepare specifications and perform oversight for a major capital improvement project, He was. unfortunately, unfamiliar with municipal requirements and/or local guidelines mandating certain approvals for the performance of the project from both the Department of Buildings (DOB) and the Board of Health (BOH). The project had to be stopped midway through for the submission of revised plans and approvals since the original specifications failed to properly address BOH requirements (though it was DOB code compliant). To obtain BOH approval, the building needed large-scale corrective remedial repairs. The process incurred unnecessary expenses that resulted in extensive delays. The contractor claimed not to be at fault since he followed the engineer's specifications, and received payment approvals; the engineer asserted that the corrective repairs were simply added value items required for the project and the board would have incurred these expenses if the specifications had been correct. The board threatened litigation against the engineer and contractor and negotiated significant reductions in both the engineering fee and the cost of the repairs.

COMMENT First, the board needs to perform due diligence with its manager in identifying the specific scope of work, establishing a budget, and engaging a construction expert, either an engineer or architect, for preparing specifications for the major capital improvement project. This should be done in conjunction with the selection of a contractor. Just as there are doctors and attorneys with designated medical specialties or areas of legal concentration, the same is true for engineers and architects. These are the professionals who have an expertise and/or area of specialization; who are more familiar with the particular construction problem, [such as the heating plant, masonry facade, electrical upgrade, or swimming pool], and/or who have more experience or knowledge with the requirements of the municipality or DOB.

Therefore, the board needs to choose wisely and conduct interviews with both the prospective experts and contractors, as well as check references and experience. The scope of work designated in the specifications is critical to the success and performance of the major capital improvement project, including the scheduling time of start and finish; progress payments, retainage and penalty provision; amount of insurance, workers compensation, umbrella coverage and deductible limit; and the type and length of guaranty/warranty.

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The use of the standard American Institute of Architects (AIA) construction agreement presents certain isues since the AIA General Conditions require significant revisions in order to properly protect the owner building. Accordingly, it is recommended that the attorney revise same and/or prepare a rider or an entire separate agreement that does not incorporate the general conditions, which are not necessarily owner-friendly. The utilization of the expert and/or the manager to perform oversight and supervision of critical stages of the project and approve payments is both necessary and essential to the success of a Project, since it enables the expert to confirm compliance by the contractor with the specifications and adherence with manufacturer's requirements, in conjunction with the issuance of the manufacturer's warranty. The lesson: proper, prior preparation prevents poor performance.

—Ronald A. Sher

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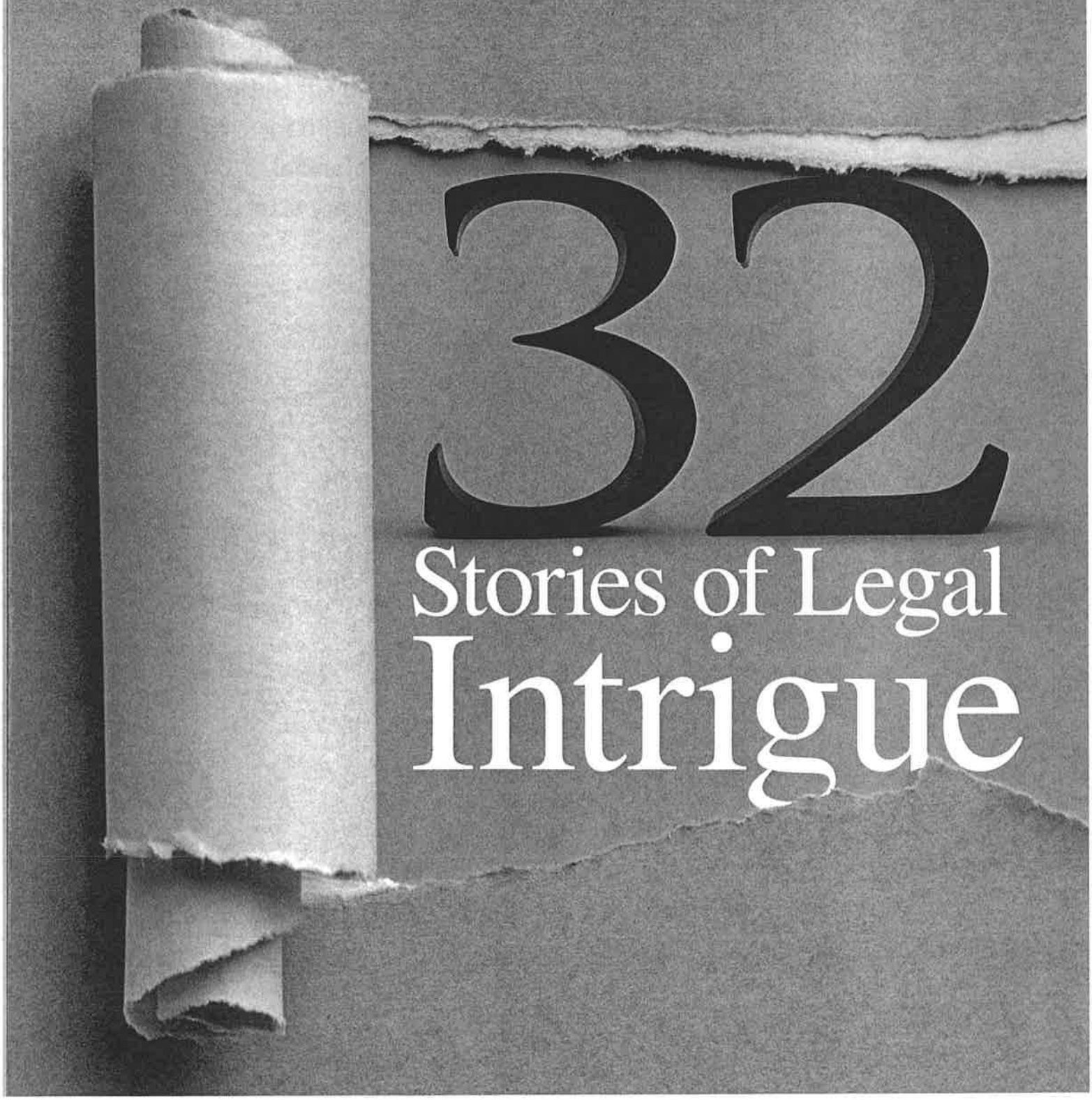

32 Stories of Legal Intrigue

Himmelfarb & Sher, Partner

Ronald A. Sher

The client's tale. The chairwoman of the admissions committee advised the board of directors that the application to purchase was denied without an interview since the prospective purchasers were not financially qualified. She noted that the amount of the loan was 90 percent loan-to-value (LTV) ratio (which was permitted under the resale guidelines), although all other purchasers were currently obtaining loans of 80 percent LTV. The chairwoman, also a member of the board of directors, was adamant in her objection and refused to even entertain any suggestions by the other committee members, who were in favor of approving the applicant – under the condition of a substantial maintenance escrow and/or financial guarantee – and scheduling the interview. The seller's attorney subsequently contacted our office and reported that the chairwoman allegedly called the seller to say that their application was rejected. She then attempted to purchase the apartment for her daughter at a similar price (and without broker fees).

We advised the president of the corporation of the allegation and recommended a special meeting of the board of directors to review both the purchase application and the allegation of impropriety. During the special meeting, the chairwoman strenuously opposed the recommendations of the other admissions committee members. The president confronted her with the allegation of impropriety. She acknowledged it but steadfastly denied any wrongdoing, insisting that she and her daughter were stronger financial candidates for the corporation since the purchase would be in cash. The board disagreed with these misguided assertions and approved the purchaser's application (contingent on a maintenance escrow). It also unanimously removed the chairwoman from the admissions committee and demanded her resignation from the board.

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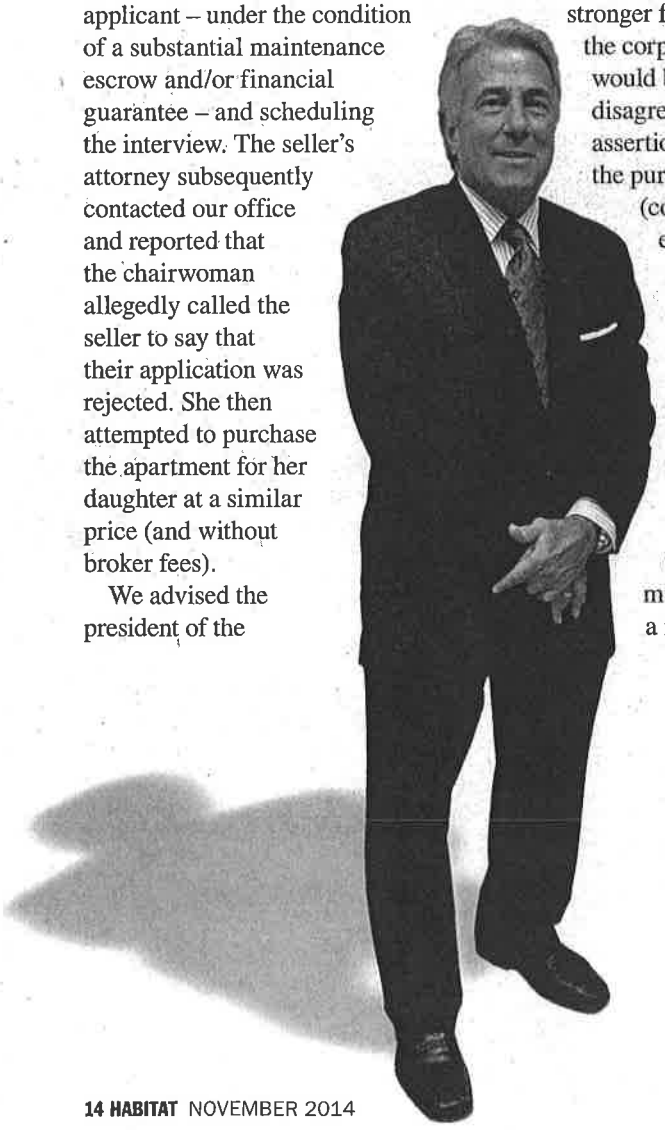
Board Clients: 75

Location:
NYC: **40%**
WC: **60%**

The lawyer's take. The board did the right thing. The chairwoman's misconduct constituted a material breach of her fiduciary duties and exposed the corporation to liability for "impermissible self-dealing and tortious interference with contractual rights" (i.e., she was illegally putting her needs ahead of the building's rules and the law).

The criteria for the selection of prospective purchasers should be determined on a case-by-case basis, following the provisions of the proprietary lease and bylaws as well as the resale guidelines. All applicants must have favorable financial documentation. The board must act in a proper, lawful, nondiscriminatory manner in compliance with the human rights law and Fair Housing Act. Finally, the committee should submit its recommendations to the board for any proposed rejection or denial of a sale or sublet. This will provide an opportunity for the board to review the process behind the committee's recommendation.

Case closed. The board may be the captain of the co-op ship, but the admissions committee is the first mate and charts the course, trims the sails, and steers the rudder. And hopefully, it doesn't cause a shipwreck or have the directors walk the plank.



No, you can't buy this apartment. **I'm on the board and I want it.**

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AN ESTATE-PLANNING PRIMER

Estate-planning primer: do you know what type of owner you are? The answer can spare you headaches. Boards should contact shareholders/unit-owners to facilitate the review of their stock certificates and proprietary leases or their deeds to determine the specific type of title ownership that is designated. This is a simple task and needs to be performed now, because many who purchased their apartments before January 1, 1996 may be under the mistaken impression or unfortunate misconception that they own their respective cooperative units, without the proper title designation, of either (i) joint tenants with rights of survivorship (JTWRS); or (ii) tenants by the entirety (TEN ENTS). These two designations permit married couples to pass their respective ownership interest in the apartment by operation of law, both without the need for probate and with certain inherent protections from creditors of the decedent.

We are constantly faced with the problem that either the people involved in these situations (a) are unaware or uninformed, (b) did not make the necessary inquiry, and/or (c) incorrectly presumed the type of ownership. They never realized the significance of date of purchase or simply did not look at the stock certificate before the closing. We require that all sellers submit the same in advance of a closing, so that we can ensure the enabling power of the surviving spouse to sign the transfer documents and validity of the transfer or sale.

We have found that many shareholders and unit-owners who purchased their apartments before 1996 – when the law changed the presumption of ownership in favor of marriage or married persons – are unaware of how they hold title or simply presume they have rights of survivorship and title passed by operation of law at the time of death of their decedent spouse. Accordingly, any married couple that purchased after January 1, 1996, in the absence of a title designation, is presumed to hold title as JTWRS, TEN ENT, or as husband and wife, with all rights of survivorship benefits and protection from creditors.

What should a board do to help shareholders and unit-owners obtain peace of mind? First, send a letter to all owners suggesting that they look at their stock certificate or deed, especially if they acquired the apartment prior to 1996, to determine if the correct title designation appears on the shares of stock or deed for JTWRS, TEN ENT, or H&W. Then, recommend they check with their personal or estate lawyer, transfer agent, or managing agent to ascertain the proper procedure to change the title designation. This simple exercise can save you time, avoid the necessity to probate, and avert unnecessary legal expenses, especially if both spouses are still alive and can facilitate the expeditious appointment of an executor. ■

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