

# The Metropolitan Corporate Counsel

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## Protecting Against Corruption In Construction and Renovation: Corporate Counsel's Essential Role In Making Integrity Pay Problems and Solutions

By John E. Osborn

Our law firm's practice concentrates in representing commercial and residential property owners on construction and environmental law matters. Our practice also includes advising clients on selecting architects, engineers, consultants and contractors, developing the bid process and drafting and negotiating construction and environmental contracts.

In addition to helping our clients obtain the best price under the best contract terms, we are increasingly asked by clients who are property owners to "check out" the financial stability and integrity track record of contractors, design professionals and other participants in the construction process.

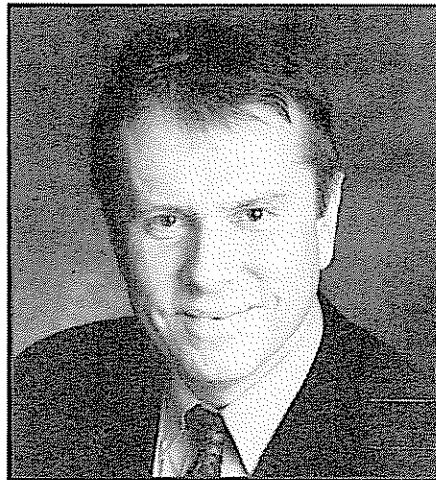
### Increased Focus On Underwriting Integrity

The focus on underwriting the integrity of contractors, design professionals and others has been heightened by the Manhattan District Attorney's ongoing investigation. In spite of the glare of publicity, it is clear that protections cannot be effective without inhouse commitment. Inhouse counsel is best positioned to institute reform and make sure it gets implemented.

On October 21, 1999, the Manhattan District Attorney's Office announced that 31 architects, real estate brokers and man-

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*John E. Osborn is a Partner in the New York City and Chappaqua, New York, law firm of John E. Osborn P.C., which concentrates in construction contract and commercial litigation and environmental law.*



John E. Osborn

agers, and 24 other companies, had pleaded guilty to bribery charges relating to bid rigging on construction projects ranging from the Bertelsmann skyscraper in Times Square to a bank on Wall Street.

The announcement marked the latest round in the five-year investigation of the \$6 billion interior construction business. The New York Times, on October 22, 1999, reported that the inquiry is far from over.

Previous indictments, convictions and plea bargains precipitated by the Manhattan District Attorney have swept through residential property management industry. In turn, the Real Estate Board of New York has acted strongly by expelling from its own membership those pleading guilty to or convicted of a felony such as bribery or bid rigging and by adopting the *Real Estate Board of New York's Code of Ethics and*

### *Professional Practices.*

On the commercial side, the Building Owners' and Managers' Association of Greater New York held an Industry Alert Seminar, "Integrity Pays," on December 8, 1999. I had the opportunity to participate in the seminar, define the legal issues involved and identify the factors that make owners of large properties and their tenants, who are building out interior space in Manhattan, a "high risk group." The program featured remarks by the attorney who spearheaded the Manhattan District Attorney's investigation, Blake Coppotelli, Esq., Chief, Labor Racketeering Unit and Construction Industry Strike Force. Thomas "Toby" Thatcher, President, Thatcher Associates, LLC, formerly head of Organized Crime Strike Force and former Vice President and Inspector General of the New York City School Construction Authority presented guidelines on preventing corruption practices.

### The Manhattan District Attorney's Investigation Expected To Yield Further Indictments, Pleas And Convictions

Assistant District Attorney Coppotelli discussed the problem: the interior construction industry is susceptible to corrupt practices such as bid rigging, bribes and kickbacks. The very nature of the industry – time pressures and long term personal relationships among many participants in the process – allows for various tiers of participants to help and reward each other (subcontractors reward contractors, contractors reward owners' representatives and architects).

**John E. Osborn, P.C. (212) 576-2670**

This corruption raises the ultimate price to the property owner.

### **The Key Is Taking Pro-Active Steps Before The Integrity Breach**

Thacher Associates' President, Toby Thacher outlined solutions and emphasized preventive measures. He recommended six specific areas of focus for owners of large properties: (1) codes of business ethics; (2) evaluation of policies and procedures; (3) vendor pool qualifications; (4) budget analysis; (5) contract language; and (6) compliance programs.

### **Manhattan Commercial Property Owners And Tenants: A "High Risk" Group**

Large commercial property owners and tenants who are building out interior office space in Manhattan are a "high risk group" for the following reasons: (1) need to build fast; (2) not knowing how to choose design professionals and contractors; (3) not knowing what is "in bounds" ethically; (4) no detailed knowledge of analyzing plans and specs; (5) no detailed knowledge of analyzing construction costs; (6) not aware of basic business mechanisms to protect corporate assets; (7) not knowledgeable in drafting contracts containing strong protections; (8) not knowing how to get tough inhouse; (9) not knowing how to use a lawsuit to best advantage; and (10) not knowing how to monitor integrity of outsourced vendors.

### **In The Face Of An Integrity Crisis: Inhouse Counsel Must Act Firmly, Promptly And Decisively**

Once bid rigging or bribery is suspected on an ongoing construction project owned by your company, inhouse counsel must act firmly, promptly and decisively. Complications make it difficult to investigate and resolve corruption issues while continuing to get the project completed. Failure to act promptly assures that recourse will be limited: freezing assets of corrupt parties and achieving restitution before the proceeds of the crime are dissipated or hidden can only be carried out if a team is immediately assembled.

### **Inhouse Counsel Is Best Positioned To Assemble A "Swat" Team Headed By Outside Counsel**

Inhouse counsel is in the best position to put the team together and to choose appropriate outside counsel to head the team. Acting when the chips are down is a strong suit

of outside counsel. Outside counsel can help save the day in gaining restitution, in being tough but discreet with your own people, especially executive staff, and dealing promptly and strongly with design professionals, contractors and consultants. Once a corrupt practice is caught, with outside and independent legal help, it can be addressed immediately. Agreements on restitution, freezing funds, bringing about forfeiture because of integrity breaches but keeping it all confidential — can all be accomplished.

In particularly sensitive situations, for example, when a head of facilities is involved with the corrupt practice, then seasoned outside counsel is necessary and must be teamed with forensic accountants and investigators. Moving quickly is essential. Gaining restitution, obtaining resignations, and freezing assets can happen when it is done promptly. Accuracy and sensitivity to legal liability aspects are also essential. Corrupt parties can be portrayed as victims and become plaintiffs. Even when property owners are right they can be sued and lose if the investigation invades privacy rights or is done without regard for confidentiality. Outside counsel are trained in moving quickly and carefully while setting a plan to "pick up the pieces" so that ongoing construction and renovation can continue without a hitch.

### **An Integrity Crisis Can Galvanize Inhouse Counsel's Efforts To Implement Integrity Reforms**

Most importantly, inhouse counsel can use an integrity crisis to achieve the implementation of reforms. In short, adopting the following 10 steps will go a long way to assuring that integrity breaches will not dissipate corporate assets:

1. Choose inhouse staff and managing agents very carefully. Measure them by integrity standards and assess their knowledge and leadership in promoting integrity in previous placements. Set and follow procedures and develop a training program emphasizing integrity issues.
2. Implement a well-designed inhouse integrity and ethics program which has the full support of senior management. Accessibility to report integrity infractions is essential, as is the concept that those who fail to report crimes will suffer the same consequences as those who commit them.
3. Implement a thorough and professional program for pre-qualifying contractors, design professionals and vendors.

4. Adopt a well thought out bid process featuring pre-award interviews that allow for elimination of inappropriate or erroneous bids.

5. Use contracts that best protect the owner's interests, and allow the owner to terminate and assess damages against contractors and design professionals who are later discovered to have had integrity problems. This can be accomplished through (a) having bidders fill out a short pre-bid questionnaire which includes a pledge that the bidder has no integrity problems and (b) requiring a contract clause which provides that the contractor forfeits the right to be paid, based upon fraud in the inducement, if the integrity representations prove false.

6. Require accurate and detailed records to be consistently maintained and made accessible for audit by the owner at all points in the project.

7. Implement a strong independent audit process that employs professionals who know the construction and renovation process and how to measure value.

8. Use a strong budget analysis from the outset that is able to evaluate changes in scope, cost and value as the project progresses and is able to measure value.

9. Implement a well-developed, precise, streamlined change order process that allows for prompt, yet thorough, decision making.

10. Emphasize the importance of paying attention to details while being able to see the bigger picture.

### **Conclusion**

In the wake of the Manhattan District Attorney's highly publicized identification of construction industry corruption as being pervasive and systemic, it is essential for inhouse counsel to understand that taking affirmative steps to guard against corruption in construction, renovation and facilities management are consistent with meeting corporate fiduciary duty. Addressing these issues is most difficult for companies whose core business is not in constructing and renovating and for companies who lack inhouse facilities management and design professional staffs. In particular, inhouse counsel to companies who are about to embark on large construction or renovation projects, and who seldom do so, are best advised to bring in a corruption prevention team at the front end or face embarrassment later.