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The CERCLA Divisibility Defense: Back from the Dead?

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On September 25, 2014, the United States Court of Appeals for the Seventh Circuit issued a decision that may resuscitate the all-but-dead divisibility defense in cases brought under Section 107 of the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"). This decision has the potential to be a game-changer with respect to easing defendants' burden in limiting their CERCLA liability exposure at multi-party contamination sites.

The Supreme Court Affirms the Divisibility Defense in Its 2009 Decision in *Burlington Northern*

Because CERCLA liability is typically joint and several, potentially responsible parties ("PRPs") with even minimal contributions to a contaminated site may be held liable for all response costs associated with a site cleanup. Environmental cleanups can be costly, and joint and several liability is not only unnerving, but it can also be an impediment to a viable defense.

PRPs were encouraged, however, by the Supreme Court's 2009 decision in *Burlington Northern & Santa Fe Railway Co. v. United States,* 129 S. Ct. 1870 (2009), in which the court held that joint and several liability can be avoided if a PRP can demonstrate that there is a "reasonable basis" by which to apportion liability among the parties. If such a showing is met, the PRP will only be liable for its "divisible" share. Potential evidence relevant to this showing includes the length of time that a PRP operated at a site, the volume of waste contributed, or the percentage of the site utilized by that PRP.

Lower Courts Refuse to Apply *Burlington Northern*

Yet, the optimism surrounding the *Burlington Northern* decision was diminished by a series of district court decisions rejecting divisibility in favor of joint and several liability. These opinions suggest that defendants are being held to a higher burden than the "reasonable basis" standard articulated in *Burlington Northern* in cases involving sites that have a long history of contributions of similar contaminants from multiple parties.

For example, in *Ashley II of Charleston v. PCS Nitrogen,* 746 F. Supp. 2d 692 (D.S.C. 2010), an owner of a fertilizer plant filed a CERCLA claim under Section 107 against the defendant, a successor in interest to a former owner, seeking a declaratory judgment that the defendant was jointly and severally liable for the cost of remediating the site. The defendant in *Ashley* presented the court with five methods for apportionment based upon: (1) the amount of fill contributed during each ownership period; (2) the volume of contaminants; (3) how long each party operated the site; (4) the disturbance of various portions of the remediation area; and (5) which soil samples were believed to be impacted by a particular defendant. Despite the force of this showing, the court found that there was no reasonable basis for apportionment in light of the "commingling of wastes, the migration of contamination over time, and other complex fact patterns." The concept of "commingled" waste disposal has indeed been problematic in trying to limit liability.

In *United States v. NCR Corp.,* 2013 U.S. Dist. LEXIS 62265 (E.D. Wis. May 1, 2013), the district court was even more dismissive of attempts to prove that the harm to the environment was divisible. *NCR Corp.* involved discharges of hundreds of tons of polychlorinated biphenyls ("PCBs") into Wisconsin's Lower Fox River by paper mills operating along the river from 1954 to 1971. The defendant, NCR Corporation, did not challenge its liability, but rather asserted that other entities should share responsibility in funding the estimated half-billion dollar cleanup of the river. To this end, NRC Corporation submitted to the court a considerable amount of expert testimony demonstrating that, based on the mass of contaminants in the river, it alone could not have contributed all of the PCBs at issue. The district court rejected this "mass-based" approach and concluded that there was no possible basis for apportioning liability. Further, the court noted that exceptions to joint and several liability are "rare"—a marked divergence in tone from the Supreme Court's approach to divisibility in *Burlington Northern.*

Yet, the optimism surrounding the *Burlington Northern* decision was diminished by a series of district court decisions rejecting divisibility in favor of joint and several liability.

The Seventh Circuit Reverses Course on Divisibility

On appeal, the Seventh Circuit in *United States v. P.H. Glatfelter,* 2014 U.S. App. LEXIS 18436 (7th Cir. Sept. 25, 2014), reversed and remanded the district court's decision on NCR's divisibility defense, noting that the district court improperly engaged in an "oversimplification" of the nature of the contamination at issue. The Seventh Circuit also seemed to admonish the district court for failing to carry out its fact-finding duties in evaluating and vetting the mass-based approach of at least one of NCR's experts.

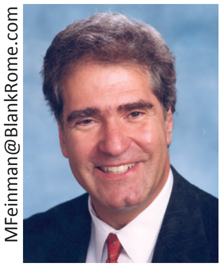
The impact of this decision, however, could extend far beyond the individual facts of this case. By requiring a more in-depth analysis to the applicability of the divisibility defense, the Seventh Circuit seems to be sending a shot across the bow that district courts have not been faithfully applying the divisibility standards enunciated in *Burlington Northern.* Specifically, the Seventh Circuit reiterated and reinforced the Supreme Court's holding that divisibility need not be proven to a mathematical certainty, but rather courts only need to find a "reasonable basis" for apportionment. Whether district courts will take heed, however, remains to be seen.

In light of these recent developments, companies confronted with CERCLA claims should carefully consider (or reconsider) their opportunity to limit CERCLA liability on the basis of a divisibility defense.

If you have any questions about the impact of this decision, please contact Margaret Anne Hill, Louis Abrams, or Frank Tamulonis of Blank Rome's Environmental, Energy, and Natural Resources practice group. □

Springing Recourse for Breach of Solvency and Debt Payment Covenants? Does New York Need *Cherryland* Legislation?

BY MICHAEL J. FEINMAN



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Two cases decided in late 2011 that held guarantors personally liable for loan repayment under "recourse carve-out" (also known as "bad boy") guaranties engendered significant criticism and fear of unanticipated liability among sponsors of commercial real estate projects. Both cases applied Michigan law, and in both cases the carve-out guarantor was held liable based on a "springing recourse" provision despite the fact that the guarantor claimed, with good reason, that it had committed no "bad act" but was rather simply a victim of adverse market conditions. The cases were criticized as imposing liability on guarantors in situations where liability was never intended to be imposed, and gave rise to *ex post facto* legislative action by the State of Michigan, resulting in one of the cases being remanded and reversed.

An Overview of the *Cherryland* and *Chesterfield* Cases

The two Michigan law cases are *Wells Fargo Bank NA v. Cherryland Mall Limited Partnership,* 295 Mich. App. 99 (Mich. Ct. App. Dec. 27, 2011) ("Cherryland"), decided by the Michigan Court of Appeals, and *51382 Gratiot Ave. Holdings, LLC v. Chesterfield Dev. Co., LLC,* 835 F. Supp. 2d 384 (E.D. Mich. 2011) ("Chesterfield"), decided by the U.S. District Court for the Eastern District of Michigan, applying Michigan law. Both cases dealt with commercial mortgage documents that were in wide use at the time and continue to be widely used.

Both *Cherryland* and *Chesterfield* involved a mortgage lender's claim that the guarantor was liable for a deficiency—that is, the amount by which the unpaid debt balance exceeded the amount received by the lender from a foreclosure sale—because (1) the borrower had breached the "Single Purpose Entity" ("SPE") covenants in the loan documents and (2) the guaranty by its terms imposed liability for full loan repayment ("springing recourse") if a breach of the SPE covenants occurred.

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Springing Recourse for Breach of Solvency and Debt Payment Covenants? Does New York Need *Cherryland* Legislation? (continued from page 2)

In *Cherryland,* the court held that the Guarantor was liable for a breach of a Borrower covenant to remain solvent. The specific SPE covenant at issue in *Cherryland* reads as follows:

> **"The Borrower shall not…for so long as the mortgage loan shall remain outstanding…fail to remain solvent or pay its own liabilities…only from its own funds."**

The Guarantor in *Cherryland* did not contest the fact that the Borrower was insolvent (insolvency was in fact stipulated to the appeals court); the Borrower's insolvency was largely attributable to the steep decline in the real estate market that accompanied the financial crisis. Instead, the Guarantor argued that insolvency caused by market conditions—as opposed to affirmative "bad acts" of the Borrower or Guarantor—was never intended to be a violation of the SPE covenant or to trigger Guarantor recourse. The court recognized that holding the Guarantor liable for the full amount of the loan in such circumstances seemed inconsistent with the perceived nature of nonrecourse debt but, basing its decision on principles of contract interpretation, found the language of the guaranty to be unambiguous. The court stated that it was not the court's job to save litigants from their bad bargains or their failure to read and understand the terms of their contracts.

The *Chesterfield* case involved a claimed breach of an SPE covenant with similar wording, but the court's focus was different. In Chesterfield, the covenant stated that [the Borrower shall not] "become insolvent or fail to pay its debts and liabilities from its assets as the same shall become due." In *Chesterfield,* the lender claimed that there was a solvency covenant breach, and therefore springing recourse liability, by reason of the Borrower's failure to pay debt service under the mortgage loan. The Guarantor objected, saying that such a reading of the SPE covenant was improper and would produce "absurd," "ridiculous," and "draconian" results by imposing full recourse liability for *any* payment default, thus converting a nonrecourse loan into a recourse loan. The *Chesterfield* court rejected this argument, determining that such a result was the proper interpretation of the contract language, and holding the Guarantor personally liable for the deficiency.

Legal Criticism of the Cases

The *Cherryland* and *Chesterfield* cases were criticized as imposing unintended liability on guarantors based on overly-literal readings of the guaranties, and gave rise to a large number of articles and to the Michigan legislature's adoption of the Michigan Nonrecourse Mortgage Loan Act, 2012 PA 67, MCL 445.1591 et. seq., effective March 29, 2012 ("NMLA"). The NMLA provides that any provision in a loan document resulting in the determination that a post-closing solvency covenant is a nonrecourse carve-out is against public policy and unenforceable. On appeal, the Michigan Supreme Court, after rejecting a constitutional challenge to the application of the statute in the case at bar, remanded *Cherryland* to be decided in light of the NMLA. Upon remand, the Michigan Court of Appeals held the guaranty provisions in *Cherryland* to be invalid and unenforceable. *Wells Fargo Bank NA v. Cherryland Mall Limited Partnership,* 300 Mich. App. 361 (Mich. Ct. App. April 9, 2013).

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The *Rich Albany* Case

A New York trial court, when recently faced with similar questions, refused to enforce a carve-out guaranty for full recourse obligations, even though the SPE covenants at issue and the springing recourse provision were similar to those reviewed in *Cherryland* and *Chesterfield.* The case—*U.S. Bank National Association v. Rich Albany Hotel, LLC,* 2013 N.Y. Misc. LEXIS 5812 ("Rich Albany")—was decided December 16, 2013, by the New York Supreme Court (which is a trial level court, despite the court's name) in Albany County, by Justice Michael C. Lynch.

The *Rich Albany* loan documents were structured slightly differently than those in *Cherryland* and *Chesterfield,* but covered similar territory. In *Rich Albany,* (1) one of the SPE covenants, the breach of which gave rise to springing recourse, was a Borrower obligation to "remain solvent" and "maintain adequate capital in light of its contemplated business operations" and (2) another enumerated springing recourse event was if the Borrower "shall generally not be paying its debts as they become due."

With regard to the solvency covenant, the lender argued that (1) a decline in the value of the property to below the debt balance violated the covenant, and (2) the failure to pay debt service constituted failure to maintain adequate capital. The lender also argued, as the lender in *Chesterfield* had argued, that failure to pay required debt service payments triggered full recourse because the Borrower was generally not paying its debts.

The *Rich Albany* court rejected both the solvency and loan payment breaches as grounds for imposing recourse liability. It rejected the notion that either simple balance sheet insolvency (loan balance in excess of property value) or failure to make required loan payments was, without more, grounds for imposing recourse liability, stating that such holdings would nullify the loan's nonrecourse structure. Instead, it determined that proper construction of the contract dictated that the court not be overly literal in its interpretation of the debt and solvency covenants in its effort to construe and enforce the document.

Conclusion

The State of New York has not adopted legislation similar to the NMLA, and without the catalyst of New York court decisions that adopt the reasoning of *Cherryland* and *Chesterfield,* it is unlikely that the legislature will seriously consider such legislation. While the *Rich Albany* case provides some comfort to guarantors who fear they will be asked to repay nonrecourse loans in all cases, the case is not an authoritative precedent for other New York courts. Until either higher New York courts rule on the question, or the State of New York takes legislative action, lenders, borrowers, and guarantors should be sure to clarify whether failure to pay the borrower's debts or simple balance sheet insolvency will (or will not) impose full recourse liability upon the guarantors, and whether the violation of a solvency requirement due to circumstances beyond a borrower's control will (or will not) be considered a violation of SPE requirements.

As to existing documents on which the ink is already dry, there is hope that the reasoning applied by the court in *Rich Albany* will help counter overly expansive efforts to impose liability where no "bad acts" have occurred. ◘

Mid-Construction Refinancing: Opportunity or Plunge into the Void?

BY MICHAEL J. FEINMAN AND BETH A. BERNSTEIN

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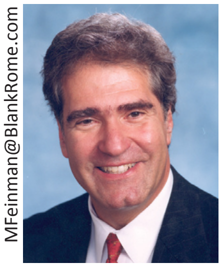

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Construction loans typically do not get refinanced before a project is completed. A construction loan is short-term in nature and both the lender and its customer expect that they will stay on the project until the project is complete, following the ground rules and administrative framework they negotiate. There are some occasions, however, where mid-construction refinancing makes sense, particularly in the current environment where financing conditions are improving and more lenders are willing to finance projects in desirable markets (such as New York City) on better terms than were available a short time ago. Some projects that are currently underway were started when the markets were tighter, and are now better able to attract loans on more favorable terms.

A lender who steps into a project in mid-course is a newcomer to a party that has already started: the borrower, its architect, contractor, and sub-contractors have already negotiated their arrangements, and have established requisition and other procedures with the now exiting lender. Whether the new lender

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Mid-Construction Refinancing: Opportunity or Plunge into the Void?
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will be welcomed to the party is uncertain, and separately (and potentially more troubling), there may be surprises that the newcomer will have to face lurking beneath the surface.

General Construction Lender Risks

Construction and its administration can be a rough and tumble process. There is an inherent tension between construction lenders, on the one hand, and design and construction companies, on the other hand, both seeking to protect their ability to recover as much as they claim entitlement to, ahead of other claimants, if a project fails to proceed as planned. New York's statutory scheme—embodied in the Lien Law—strikes an uneasy, and often unwieldy, compromise between the competing interests of the construction trades and banks and other construction lenders.

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Funds received by an owner as advances under a "building loan contract" (*i.e.,* a construction loan agreement) are trust assets under a statutory "trust fund" created by the Lien Law, for the benefit of those whose labor and materials improve real property, and the statute requires owners to act as trustees and to apply such assets for payment of the "cost of improvement" and for no other purpose. Included in the definition of "cost of improvement" are labor and materials, a number of other construction-related items, as well as interest and principal on building loan mortgages.

The main lender risk imposed by the Lien Law arises under Section 22, which requires that a building loan contract contain a statement sworn to by a borrower representative—known as a "Section 22 Affidavit"—which sets out all expenses to be incurred in connection with the improvement, as well as the remaining amount, representing the "net sum available to the borrower for the improvement." If the requirements of Section 22 are not complied with, the consequences are severe—the parties to the building loan contract (most notably the mortgagee) lose lien priority to a permitted lienor's subsequently filed lien. Thus, although the lender does not sign the Section 22 Affidavit, the statute puts the lender at risk if either (1) the contents of the Section 22 Affidavit are false, or (2) the proceeds of the building loan are not applied in accordance with the Section 22 Affidavit.

Another lender risk relating to construction loans is the risk that amounts paid to a lender will be required to be disgorged as improperly diverted trust funds. The owner, and not the lender, is generally charged with responsibility for maintaining the trust assets and ensuring that they are properly applied for the "cost of improvement." However, if trust funds are diverted, or are paid to payees in an improper order of priority, the recipient can be forced to return them, even if the recipient had no knowledge of the improper diversion. Fortunately, the Lien Law provides a relatively clear route for a lender to avoid a diversion-of-trust-assets claim, by permitting a lender who expects to receive funds from the borrower in repayment of its loan to file a "Notice of Lending" under Section 70 of the Lien Law, specifying the advances it is making to the borrower for which it expects to receive payment out of the statutory trust funds.

Another possible trouble area relates to modifications of building loan contracts. Under the Lien Law (also Section 22), any modification of a building loan contract must be filed within ten days after it is executed and, although not specifically prescribed by the statute, the filing offices (the applicable County Clerk) generally require a newly sworn-to Section 22 Affidavit to be submitted at the time a building loan contract modification is submitted for filing. Even if the parties abide by the filing requirements for a building loan modification, however, the parties cannot modify an existing building loan contract to adversely affect the rights of a party (*i.e.,* a trust fund beneficiary) who is entitled to rely on the original terms of the filed building loan contract. For example, if the lender and borrower determine that the hard cost budget will be reduced, and the interest reserve increased, a contractor (a beneficiary of the Lien Law trust) who is not a party to the modification would be able to claim reliance on the higher number specified in the originally filed building loan agreement.

Construction lenders and their counsel are (generally) careful to prepare and file the proper documents to protect the lender against the risks of violating the Lien Law and to be in a position to properly defend a Lien Law claim by a contractor or other party.

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Mid-Construction Refinancing: Opportunity or Plunge into the Void?
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When a lender steps into a mid-construction loan, it is exposing itself to as yet unasserted claims—including lien subordination, trust asset diversion and others—relating to the project. Before stepping in, the lender should do as much as possible to identify any issues, obtain information, and receive assurances from potential claimants that eliminate or reduce the risk of future claims relating to the exiting lender's regime.

Due Diligence and Administration Challenges

As construction loans are administered, the lender and its advisors (inspecting architects and, as needed, counsel) review monthly requisitions and periodic progress reports to determine how the project is proceeding. As part of the monthly requisition process, the lender obtains lien waivers, certainly from the general contractor or construction manager, and probably from identified "major subcontractors." Also, as part of the monthly draw process, the title insurer issues a title continuation, which indicates whether any mechanic's or other liens have been filed. If there is unsatisfactory work, design and field changes, or delays, the lender team is apprised of them, but may not always detail them exhaustively. Moreover, if things "all in all" seem to be progressing, a lender will often defer taking enforcement action, or threatening to do so, in the hopes that the ship will right itself.

When a lender steps into a partially completed project, it must be mindful that the parties may have accumulated issues that require ongoing dialogue and negotiation. Things may have deviated from the original plan, as they often do, with the parties understanding, more often informally, that they will re-visit and reconcile identified issues in a later month. The task of the replacement lender is to understand both the written record and the rest of the story that may be unwritten.

Although the exiting lender would be a good source of information, it is likely to be uncooperative. First, normal commercial prudence (and advice of counsel) will likely dictate that the exiting lender make as few representations as possible. Perhaps more importantly, the exiting lender may be being replaced unwillingly, for example because the new lender's terms are better, giving the exiting lender an added disincentive to cooperate. This dynamic may change somewhat if the exiting lender is itself eager to make an exit.

How then can a replacement lender get comfort that it is not stepping into a mess? It can require that copies of the entire draw package for each advance be delivered to it by the borrower, as they were delivered to the exiting lender. It can inquire of the title insurer whether it has omitted (insured over) any recorded mechanic's liens either currently or in the course of construction. While "insurance over" is a matter that should be disclosed to the insured (the lender and the borrower), there are instances where title insurers will issue a clean title continuation based on an indemnity (or other underwriting consideration) from the borrower (who is in many instances the party with the relationship with the insurer or its agent). If a lien has been insured over, a subsequent lien that is not insured over will "date back" to the earlier filing date, as a matter of law. The new lender may insist that a new title insurer be brought in, to give the project a fresh start, but the feasibility of pursuing this course may depend on the extent to which existing insurance arrangements will be retained or replaced and may be driven by cost.

The new lender should also review with care the existing architect and construction documents. The borrower and its representatives can be counted on to press the new lender not to "reinvent the wheel" and to accept the arrangements that are in place. There are wide variations in the marketplace relating to the level of scrutiny of design and construction documents, and the lender protections that are required. If the original lender was careful and well-represented at the time of the original loan closing, the architect/engineer and construction contracts will have been reviewed for adequacy, and collateral assignments, including "will serve" agreements, will have been executed by the design and construction parties, and consented to by the borrower. Assuming these documents are determined to be adequate and are by their terms assignable to, or run to the benefit of, a successor lender, they can continue to operate for the new lender. If any inadequacies are identified, the new lender can require modified or new agreements.

> When a lender steps into a partially completed project, it must be mindful that the parties may have accumulated issues that require ongoing dialogue and negotiation.

Even if the existing documents are strong, it may be appropriate to "downdate" some of the representations and other statements by design and construction parties, to reflect changes to the project design, budget, or scope of work since the time that the original loan closed. For example, a statement by the architect that the plans and specifications comply with law may have been accurate when issued, but may not apply to a set of plans that has been modified internally since the original closing date.

In addition to satisfying itself with the existing arrangements, it is crucial for the new lender to obtain from the main design and construction parties an estoppel certificate or other document that speaks as of the date of the new lender's arrival. The new lender is entitled to know that the contracts it is reviewing have not been modified and that there are no claims that the contractor (or design professional) has for unpaid amounts, additional work, or for matters that were agreed to be addressed or resolved at a future date. Also, because the design and construction parties are beneficiaries of the Lien Law's trust provisions, if the new lender is modifying the building loan contract or anything else agreed to by the exiting lender, it should get the express consent of the applicable design and construction parties to the modification, to ensure that they agree to be bound by what the lender new and borrower are agreeing to.

Like all construction lenders, those stepping in at mid-construction should consider the strength of the borrower and guarantors, and obtain (or succeed to) completion guarantees. Because there are additional risks inherent in a mid-construction scenario, including claims that are allegedly attributable to the acts or omissions of the exiting lender, a new lender should also consider requesting protection from the guarantors with regard to these incremental lender risks arising from acts or omissions prior to the date of refinancing.

The new lender will likely require an assignment of all documents from the exiting lender, and the exiting lender should not object, provided that the assignments are nonrecourse (or limit recourse to the assigning lender to a very short list of matters). Notwithstanding the assignment, it is advisable for the new lender to require a new Notice of Lending. If for no other reason, a new Notice of Lending is prudent to obtain because the County Clerk may refuse to accept an assignment of Notice of Lending, and the statute does not provide sufficient comfort that a successor lender will be protected by an assigned Notice of Lending.

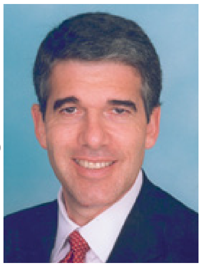
Conclusion

There are many reasons a lender may want to take over a construction loan. Perhaps the lender sees the loan as an opportunity to establish or strengthen a relationship with a developer client. Or maybe the lender has an opportunity to make a "mini-perm" loan that will enable it to capture the post-completion financing that it would otherwise lose to competitors.

Whatever the reason, it is clear that refinancing a building loan during construction raises unique and potentially costly risks for a lender. By careful due diligence and proper documentation, however, a replacement lender may get sufficiently comfortable that the shoes it is stepping into can be made to fit as comfortably as possible. ◻

Why Owners Should Care about Subcontracts Held by Construction Managers

BY MICHAEL A. SCHEFFLER



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This article explains why owners should actively participate in the development of subcontracts under a construction management agreement ("CM Agreement"). Owners often pay too little attention to this part of the subcontracting process, and yield too much control to the construction manager ("CM"). This "hands off" attitude can engender problems for the owner ("Owner"), as explained further below.

Reasons Owners Should Care about Subcontracts

There are a number of reasons that the Owner should care about the contents of subcontracts, and not rely upon the "flow down" or "incorporation by reference" clause in the subcontract. Below are just some of the reasons:

- If the Owner terminates the CM Agreement, the Owner or a new construction manager retained by the Owner may "inherit" some or all of the subcontracts.

- Certain provisions may be mandated pursuant to governmental incentive programs, and the Owner should not rely on the CM to ensure that those provisions are included in the subcontracts.

- Subcontracts will often contain a warranty or guaranty provision that differs from the similar provisions in the CM Agreement, regarding the duration of the coverage or other salient terms or conditions. While the Owner may look to the CM under its warranty or guaranty, in case the Owner decides to seek recourse against a subcontractor, it may be prejudiced in doing so if the subcontract terms are not as favorable as those in the CM Agreement.

- The Owner should be named in the subcontract as a beneficiary under the subcontractor's warranties and guaranties, an additional insured and indemnitee, and an obligee under payment and performance bonds. The Owner may also be required, by a lease or mortgage, to extend the same protection to the lessor or mortgagee.

- In addition, the Owner should be specifically designated as a third-party beneficiary under the subcontract with respect to all other provisions set forth in the subcontract expressly stated to benefit the Owner or otherwise naming the Owner.

- With the Owner being designated as an indemnitee and beneficiary under the subcontract, it is important to add a statement that such a designation should not be deemed to create contractual privity between the Owner and the subcontractor (except for the subcontractor's indemnity and other contractual obligations in favor of the Owner) or otherwise give rise to any obligations or liability on the part of the Owner in favor of the subcontractor.

- There are certain other subcontract provisions that the Owner will want to remove or nullify, such as, for example (1) a "liquidating agreement" (or "pass-through") provision, (2) a cross-default between the subject subcontract and other subcontracts between the CM and the same subcontractor, and (3) a clause permitting the CM to offset against payments due to the subcontractor on the Owner's project amounts that the subcontractor may owe the CM on a different project.

- The subcontract should permit the CM to assign the subcontract to the Owner or its designee, without obtaining the subcontractor's consent. The assignment provision should state that the Owner can effectuate the assignment by simply sending notice to the subcontractor (*i.e.,* without the CM's confirmation).

> Owners often pay too little attention to this part of the subcontracting process, and yield too much control to the construction manager.

- To avoid any doubt as to whether the incorporation by reference of the CM Agreement expires upon the termination of that agreement, the subcontract should provide that if the CM Agreement is terminated for any reason, the agreement continues to be "alive" as so incorporated.

- The *force majeure* provision in the subcontract should state that if the CM Agreement is more restrictive in terms of the amount of time allowed for extensions, then the subcontract provision should be deemed modified to conform to those more restrictive terms.

General Practice

The general practice is that the CM will use its own subcontract form, and even if the Owner does review the form, the Owner may not review the actual completed subcontract before it is executed. Owners may also not obtain copies of the executed subcontracts.

There are several problems with this practice, from the Owner's perspective:

- Even if the subcontract contains a customary provision incorporating the CM Agreement by reference, it is very possible that the CM will not provide a copy of the CM Agreement to the subcontractor, which would make it more difficult to bind the subcontractor to provisions in that agreement.

- Even if the subcontractor is given a copy of the CM Agreement, the inclusion of the customary incorporation by reference provision may not be sufficient to bind the subcontractor to certain key terms in the CM Agreement, such as those not involving the scope, quality, character, or manner of the work.

- When the approved form of subcontract is attached as an exhibit or otherwise established as the prescribed form to use, the Owner should still review the actual subcontract agreements before they are executed to ensure that no material changes were made to the approved form.

- The Owner's failure to obtain copies of the executed subcontracts can present problems if the Owner terminates the CM but wants to continue working with the subcontractors under their existing subcontracts, or the Owner seeks to enforce the subcontract provisions benefitting the Owner.

How to Correct Problems with General Practice

- Given the CM's desire to work with its own form of subcontract, the Owner should provide a rider to be annexed to each subcontract, which incorporates important concepts found in the CM Agreement and addresses weaknesses in the CM's form of subcontract.

- The CM Agreement should require the CM to employ the subcontract form and rider annexed as exhibits.

- The CM should provide to each subcontractor a copy of the CM Agreement, redacted to prevent disclosure of monetary and other confidential terms.

- The Owner should review the final execution version of the subcontracts (redacted if appropriate) to ensure that any changes made by the CM to the standard form are acceptable.

- The Owner should obtain copies of the executed subcontracts (again, redacted if appropriate). ◻

RECENT NOTEWORTHY DEALS

Blank Rome's real estate group recently represented:

- **DRA Advisors LLC,** an investment advisor specializing in real estate investment and management services, in several transactions, including:
  - **DRA Advisors LLC** and its portfolio company **Capital Automotive L.P.** ("CARS"), the leading owner and landlord of automobile dealership properties in the United States, in the structure and negotiation of agreement for the sale of CARS to affiliates of Brookfield Asset Management Inc., a New York Stock Exchange-listed REIT.
  - The sale of 64 multi-family properties located throughout nine states and totaling more than 20,000 units, to global private equity firm, **Lone Star Funds.**

- The **New School** in the leasing of 9,000 square feet of retail space to **CVS/Pharmacy** on the ground level of the school's new University Center, which opened in January 2014. The retail space sits at 2 West 14th Street, at the intersection of 14th Street and Fifth Avenue. The CVS location opened in September 2014.

- **Shinhan Bank,** headquartered in Seoul, Korea, as administrative and collateral agent in closing a $120 million syndicated term loan secured by a class-A building located in Washington, D.C. Other participating lenders in the transaction were **Hana Bank** and **Woori Bank,** large Korea-based banks. ◻

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