

# advisory

## THE INTERSECTION OF LEGAL AND BUSINESS ISSUES

In order for a lawyer or accountant to effectively represent a corporation, it is important to take the time to understand and appreciate the business challenges in addition to the legal issues being confronted. Appreciating the underpinnings of the business operation and challenges will provide context to solving legal problems. Most businesses have many moving parts and, in this outline, we will briefly review some key issues unique to the construction industry.

Administrative, financial, personnel and/or human resources are the primary components to the backroom of a business, while the legal issues may involve contractual disputes, vendor relations, employee issues or even OSHA claims, depending upon the nature of the business. Familiarity with the business platforms, i.e., finance, accounting systems, administrative policies, procedures and management controls are important to a successful operation and provide the necessary tools to take preventative measures to avoid legal challenges.

The center of the universe in all business operations revolves around personnel and communication. For instance, job descriptions are very important in the construction industry as are training programs for those in the field. If management is proactive in developing and implementing effective systems, legal issues could be avoided and profitability might be accelerated. The basic infrastructure should include:

- Utilizing technology and developing real time accounting and record keeping
- Training management to communicate effectively
- Making certain that projects are adequately staffed
- Establishing clear lines of authority or accountability
- Establishing a framework for future growth
- Adopting effective training and orientation procedures for personnel
- Aligning the compensation system with the market
- Developing and implementing team goals

Management generally relates to accomplishing tasks, getting work done, overseeing quality of performance and the ultimate product, whether it is a widget or a building. Establishing proper controls and procedures is critical to the overall success of the business, and helps prevent mistakes that could lead to legal issues.

Leadership is all about having a vision and creating an environment in which personnel are motivated to do their job well. Coaching, supporting, motivating and inspiring employees to do their best are key leadership skills. It is all about setting a good example and modeling the behavior you want your employees to practice. Leaders can be trained and cultivated over time. If the leadership in the company demands excellence from themselves, they can inspire management and employees in the field to adopt a similar attitude and work ethic.



Representing a business effectively requires an understanding of the underlying business, as well as the legal issues they confront. Dealing with contractual issues that may be encountered is oftentimes the result of mismanagement, lack of communication or failure of leadership. For example, a contractual dispute with the owner in a construction project may be the result of how the original bid was developed or poor communication in the field. If the client has not accurately calculated the true cost of the project it will be difficult to manage the project to profitability, which results in disputes. Understanding this dynamic assists the lawyer in examining the facts leading up to the dispute, as well as providing context to a possible solution.

Assessing risk factors requires measuring your true costs against a real budget rather than a guesstimate. Labor is often the riskiest and most difficult part of the estimating process and in order for an estimate to be accurate, the process of determining how long each task will take and how much each task will cost depends on the relative efficiency of your personnel, which relates back to training and management. Without understanding the true productivity of the staff in the field, it is almost impossible to develop reliable estimates that would become part of the bid. The obvious goal of an accurate estimate is to determine true costs and to have a method of assessing the progress on the job and profitability against a predetermined benchmark.

Successful performance is usually the result of a strong infrastructure and if the lawyer understands the business model it becomes much easier to identify potential legal issues. Often times, the loss experienced in a construction project is caused by not having a systematic way of tracking costs or those in the field are not taking the time to bill for a change in the work which leads to legal disputes. Change orders can be an excellent source of additional profit; however, record keeping and communication are paramount to being successful. In order to better track and manage change orders, strict guidelines and procedures must be part of the company's DNA so that changes in the field are tracked accurately and are then turned into work orders that have been properly signed off on by the owner.

As we all know, "time is money," and that's especially true in construction. For example, if you run a job exactly as budgeted and you completed the project two weeks earlier than anticipated, the project will be profitable. The reverse is obviously true if the budget was off or the completion was delayed, which may result in a legal dispute with the owner. Both employees and subcontractors have to appreciate the job schedule, true costs and possible obstacles in order to avoid mistakes and lawsuits. A sophisticated accounting system will assist the owner and project manager by effectively communicating costs in real time. Managing costs is often driven by strong leadership, which leads to reduced costs relating to workers' compensation or liability claims.

Understanding the importance of purchase orders and change orders provides context to a potential legal dispute when the owner and client cannot resolve the business dispute. Properly closing out a job will avoid a business dispute as well as the potential legal claim. How the client defines success is critical to managing expectations when a legal dispute arises. A critical step to long term success in any industry is developing a mission statement and complete business plan that promotes clear communication to everyone involved in the business, including the lawyer. Crafting a mission statement will also help identify the company values and goals, as well as establish a realistic business plan to be implemented by management.

Money isn't the be-all and end-all of motivation...but it certainly helps! Creating performance rewards for your employees will motivate them to watch out for the bottom line. Setting profit-sharing goals based upon job responsibilities will make it easier for the employee to understand how their contribution is measured. Field personnel, for example, could be measured on job costs against budget, while office staff could be rewarded for decreased overhead costs. Establishing a range for bonuses versus setting a pre-determined percentage for all employees allows you to reward exemplary behavior. Employees will then have pocketbook feedback on how their work is viewed and evaluated. Just because someone works really hard doesn't mean they are working well. We all know the person who stays late every night and works every weekend, yet never seems to get all the work done. Don't be fooled by effort; instead, look at each employee's results.

Written procedures within a company are key to business profitability. Typically, companies create written procedures only after they lose money because something wasn't done right. The better way is to create written procedures ahead of time and avoid the failures altogether. Written procedures will provide a roadmap to new employees on how and when to do their work. Defined procedures will save you time and money and will increase your profitability – not to mention save you training dollars.

**Consider these examples:**

It only takes one instance of an incomplete lien release to understand how much money you can lose on a job. Each state has different laws, and you must know the laws that effect you so that you can pass the knowledge along to your employees. "Internal controls" will limit the risk of embezzlement and the lawyer for the company can assist in developing the controls if he or she understands the business. Developing written procedures that must be implemented for a change order is critical to avoiding unnecessary loss of revenue. Create systems that track the expiration of your subcontractors' workers' compensation because if you pay a sub without it, you will be held liable for those dollars. Consider the story of the contractor who verified liability coverage before the subcontractor started the job, but by the time it came to paying the sub, the policy had expired. The result: the contractor had to pay large sums of money to cover the subcontractor.

Communication by and among subcontractors, employees, bonding agents, architects, engineers and inspectors is critical and the company policy regarding the nature and scope of the communication must be clearly outlined to the staff person or manager in the field. Communication is both valuable and necessary. Having regular staff meetings and recognizing and rewarding good work will help keep the lines of communication open. To improve communications with various parties outside of your company, you should develop a system for producing and documenting professional-looking reports and notices. Providing documented reports, including approved change orders, bonding reports, job cost summaries, subcontractor notices, and lien releases will provide clear communication and prevent against any misunderstandings long after the job is completed.

In the end, the lawyer's understanding of the business is a prelude to effective representation whether it is to prosecute a claim, negotiate a contract or in dealing with a transaction. For more information, please contact PLDO Managing Principal Gary R. Pannone at 401-824-5100 or email [gpannone@pldolaw.com](mailto:gpannone@pldolaw.com).



Gary R. Pannone  
Managing Principal

PANNONE LOPES  
DEVEREAUX & O'GARA LLC  
c o u n s e l o r s   a t   l a w

This memorandum is intended to provide general information of potential interest to clients and others. It does not constitute legal advice. The receipt of this memorandum by any party who is not a current client of Pannone Lopes Devereaux & O'Gara LLC does not create an attorney-client relationship between the recipient and the firm. Under certain circumstances, this memorandum may constitute advertising under the Rules of the Massachusetts Supreme Judicial Court and the bar associations of other states. To insure compliance with IRS Regulations, we hereby inform you that any U.S. tax advice contained in this communication is not intended or written to be used and cannot be used for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing or recommending to another party any transaction or matter addressed in this communication.