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MTA's New Debarment Rules Threaten Contractors

NELL M. HURLEY

A new state law and its regulations, together with a January 2019 Executive Order issued by Governor Cuomo, bring serious debarment risks for contractors, consultants and suppliers doing business with New York's Metropolitan Transportation Authority ("MTA") and its many affiliated entities. Numerous construction industry and citizen organizations are urging MTA to make changes to this new debarment process and criticize MTA for pushing the regulations through without prior and proper comment periods. Legal challenges may also be presented, but for now the new danger is real.

New York's Public Authorities Law § 1279-h was passed, without public comment, as part of the State's budget bill in April 2019. It required the MTA to establish a debarment process in which (1) debarment would be imposed where the contractor fails to meet the date of substantial completion by more than 10% (ten percent) of the adjusted contract term, or (2) where the contractor's disputed work claims are found to be invalid under the contract's dispute resolution process and exceed 10% (ten percent) of the adjusted contract amount.

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Federal Court Reiterates That Contractors Abandon Projects at Their Peril Over Extra Work Disputes

MATTHEW D. HOLMES

The United States District Court for the Northern District of New York recently dismissed a subcontractor's counterclaims for alleged "extra work" on a time-sensitive apartment and townhouse construction project ("Project") where the subcontractor admitted that it abandoned the Project twice due to the general contractor's refusal to pay for the disputed work, while being current on its progress payments.[1]

The general contractor filed the federal action against its subcontractor for breach of contract and attorneys' fees based upon the subcontractor's abandonment. The Complaint sought recovery of the completion costs the general contractor incurred after the subcontractor walked off the Project twice without notice. The subcontractor's Counterclaims alleged that additional work was performed, among other things. Although the subcontract claims procedure was never followed (and there was no apparent claim made for the alleged "extra work" as the terms and conditions required), the subcontractor averred that it was excused from complying with those provisions of the subcontract. The subcontractor acknowledged that the general contractor was current on progress payments as of the time the subcontractor first abandoned the Project.

The general contractor filed a Motion for Judgment on the Pleadings to dismiss the subcontractor's counterclaims on the basis that the terms of the subcontract, and the allegations contained in the subcontractor's Answer with Counterclaims, presented no factual scenario upon which the subcontractor could succeed. The subcontract clearly stated that the subcontractor must continue work during any dispute with the general contractor over "extra work." This mandate is in accord with the long-standing law in New York that a party cannot abandon a construction project during a dispute in the face of such an agreement. The court ruled that the subcontractor could not depart from that agreed-upon process and simply cease working on the Project where the general contractor disputed that extra work was performed.

The court rejected the subcontractor's argument that the general contractor was in breach first by refusing to pay for work already performed, because the subcontractor admitted that the general contractor issued a check for the subcontractor's last payment application before the first abandonment of the Project. To the extent the subcontractor claimed that extra work was performed without compensation, it was required to "submit written notice of the asserted change or claim, complete its obligations, and, if unable to come to an agreement on the extra work, bring a cause of action of breach of contract." The subcontractor did not follow that contractual path, or even allege that it attempted to follow the agreed-upon claims process, said the court. The court specifically noted that the subcontractor was not permitted to demand additional payment for "extra work" and cease working on the Project when the general contractor refused to pay.

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No Defamation Claim Based Upon Mechanic's Lien

NELL M. HURLEY

New York's Lien Law is oddly both strict and liberal as it relates to mechanic's liens. Those providing the work must comply with unforgiving time and notice provisions to ensure the lien is valid. Once filed, though, it can remain an encumbrance on the property for years, with little effort by the lienor. This can be particularly frustrating where the owner or upstream contractor contends that the lien is inflated or even false. A recent New York case shows a novel, albeit unsuccessful, effort by a contractor to fight back against just such a lien.[1]

The contractor, Centrifugal Associates Group, LLC ("Centrifugal") was hired by the owner to perform construction work in Queens County, New York. Centrifugal subcontracted with Newell Contracting ("Newell") for certain portions of the work. Newell later filed a mechanic's stating it was owed $320,000 for work performed. Centrifugal hotly disputed that any money was owed Newell.

Instead of the typical (and inefficient) measures set forth in the Lien Law, such as forcing Newell to foreclose the lien and then asserting willful exaggeration, Centrifugal took a different tack. It commenced a lawsuit against Newell for breach of contract, and against both Newell and its president, Krzysztof Bielak ("Bielak") for defamation, based upon the alleged false and damaging information contained in the mechanic's lien.

Both Newell and Bielak failed to appear, but when Centrifugal pursued a default judgment, Bielak sought to dismiss the action. Bielak argued that he could not be individually liable since he signed the mechanic's lien in his corporate capacity and that, in any event, statements contained within a mechanic's lien are not actionable as defamation. The court agreed and dismissed the defamation claim against Bielak.

The court first recognized that Bielak could not be held individually liable for corporate wrongdoing such as of breach of contract, but that an allegation of defamation would devolve upon Bielak in his individual capacity. Second, the court ruled that the filing of a mechanic's lien is privileged, or protected from, claims of defamation for statements made therein and thus could not be used as a basis for Centrifugal's defamation action. This type of privilege is extended to statements made during or related to a judicial proceeding in which the person making the statement is protected from claims of defamation. The legal basis for this rule is to permit the efficient administration of justice.

The court rejected New York cases relied upon by Centrifugal in which other tort claims were permitted for damages resulting from the willful exaggeration of a mechanic's lien, because they did not involve the tort of defamation. The court also refused to adopt the holding of a Minnesota case in which the mechanic's lien was not privileged and, thus, a defamation action based upon the statements contained in it was permitted.

Despite the ruling against a defamation claim in this case, owners and contractors who believe they are subject to a willfully exaggerated or false lien may be able to avail themselves of other common law remedies against the lienor and/or its principals, depending upon the specific circumstances. E&D

1 *Centrifugal Assoc. Group, LLC v. Newell Contr., Inc.*, 2019 N.Y. Misc. LEXIS 2851* (Sup. Ct. Kings Cnty. 2019).

CONTINUED "MTA'S NEW DEBARMENT RULES THREATEN CONTRACTORS"

The implementing regulations[1] were issued in June 2019, with retroactive effect. In addition to the two automatic "10% rules" requiring debarment, the law and regulations strip MTA of its discretion as to whether to commence a debarment proceeding and its authority to consider any mitigating factors. If there is "any evidence" of a debarment violation, the MTA must bring the proceeding. This eliminates any allowance by MTA for why there may have been a delay or a cost overrun and directly contrasts with most other industry debarment processes, including those used for federal contracts.

Not surprisingly, however, the regulations specifically expand MTA's discretionary power as it relates to debarment of related corporate entities and affiliates, including individual partners, officers, members and managers with a ten percent or more interest in the debarred contractor, consultant or supplier.

To make matters worse, Governor Cuomo's Executive Order 192 requires that all state agencies, departments and authorities, among other state-related entities, "must rely on the determination made by other state entities in ascertaining the responsibility, ineligibility or debarment of a contractor…in current and future procurements." Put simply, debarment by one equals mandated debarment by all and, under the Executive Order, may be effective indefinitely, unless a waiver is obtained. Individual officials of the state entities "shall be breaching their duty as a public officer and/or fiduciary duty as a board member" if they select a contractor who has been debarred by another state entity.

So what does this mean for those doing business with the MTA or considering doing so? The risk landscape has just changed instantly and dramatically, and clearly not in the contractor's favor. The objective and inflexible "10% rules" require very careful evaluation of any potential claims for extra work or time extensions, with potential debarment hanging in the balance.

More importantly, the MTA's sudden debarment process change is reflective of the overall increased focus by New York State on contractor responsibility, purportedly an effort to weed out the "bad apples". But without proper input from industry stakeholders before enacting such legislation and regulations, the MTA has sent the construction industry what is considered by many to be a chilling message. Stay tuned ….and be careful out there. E&D

1 21 NYCRR 1004, et seq.

Lost Profits: No Waiver by Owner in Failing to Terminate for Late Completion

MARTHA A. CONNOLLY

When a contractor fails to meet its contractual deadline for completion, but the owner allows construction to continue, the contractor may think it has dodged a bullet, especially where no liquidated damages clause applies. As shown below, that contractor could well be wrong.

In *McPherson Bldrs., Inc. v. Performance Premises, LLC*[1], the contractor (McPherson) missed its deadline to substantially complete construction of a building to be used by the owner (Performance Premises) as a performing arts venue. Performance Premises did not terminate McPherson, as the contract allowed, but rather permitted completion of the work over the following five months. Payment was withheld for work McPherson completed after the contract deadline, causing McPherson to file and later foreclose upon a mechanic's lien. As a defense to the action, Performance Premises asserted a claim for McPherson's breach of contract for missing the completion date, and sought damages for lost profits due to the delay.

McPherson moved for summary judgment on its claim for payment and for dismissal of Performance Premises' claim for lost profits. The motion court denied McPherson's motion and an appeal followed.

The appellate court first observed that it was undisputed that McPherson failed to meet its deadline. McPherson argued that because Performance Premises did not terminate the contract, it had waived its claim to damages stemming from the late completion. The court disagreed. By allowing McPherson to continue working, Performance Premises only gave up its right to terminate based upon the delay, it did not waive its claim for the resulting damages. The court also rejected McPherson's argument that termination was Performance Premises' only remedy for the failure to timely complete. The parties' contract stated that the owner "may terminate" the contract for a substantial breach. The court noted that the language signaled an option to terminate, not a requirement.

The court found that McPherson was entitled to recover for work completed after the contractual deadline, but also that any recovery must be offset by damages the owner sustained because of McPherson's late completion. The court held that Performance Premises may recover damages for lost profits provided they were within the contemplation of the parties at the time the contract was made and could be calculated with reasonable certainty.

Performance Premises successfully demonstrated that McPherson knew the purpose of the building it was constructing, as well as the required date of completion. There was evidence of the inability to rent the space as planned including affidavits from entities addressing rental rates that would have been paid, but for the delay in completion. This was sufficient to deny McPherson's motion to dismiss the claim for lost profits by Performance Premises, said the court.

This case is a good reminder of a contractor's exposure to liability for delay damages, including lost profits, should an owner be unable to use a facility due to late completion. A well drafted "waiver of consequential damages provision", which specifically included lost profits, would likely have helped the contractor's success in dismissing the owner's claims for damages in this case. E&D

1 171 A.D.3d 1270 (3d Dept. 2019).

CONTINUED "FEDERAL COURT REITERATES THAT CONTRACTORS ABANDON PROJECTS AT THEIR PERIL OVER EXTRA WORK DISPUTES"

The court also rejected the subcontractor's attempt to advance alternative "quasi-contract" Counterclaims, because there was an express contract that governed the subject matter of the Counterclaims, and which specifically dealt with "extra work."

This decision runs lockstep with other New York courts. Abandoning a project during a dispute, in the face of a provision requiring continued performance during an agreed-upon dispute process, will expose those claims to dismissal as a matter of law. E&D

1 *LeChase Constr. Serv., LLC v Escobar Constr., Inc.*, 3:18-CV-1021 (GTS) (DEP) (July 1, 2019).

L to R, Todd Braggins, Clara Onderdonk, Tim Boldt, and Kevin Peartree

Ernstrom & Dreste Office Manager and Legal Administrator Clara Onderdonk was recently honored by the The Daily Record as a recipient of its 2019 Excellence in Law Award as an Unsung Legal Hero.

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Ernstrom & Dreste, LLP also publishes the Fidelity and Surety Reporter. If you would like to receive that publication as well, please contact Clara Onderdonk at conderdonk@ed-llp.com. Copies of ContrACT Construction Risk Management Reporter and The Fidelity and Surety Reporter can also be obtained at Ernstrom & Dreste, LLP's website (ernstromdreste.com).

FIRM NEWS

On August 1, 2019, Kevin Peartree presented a webinar for ConsensusDocs entitled *Using Master Subcontracts: Become More Efficient in Negotiating Your Subcontracts*.

Tim Boldt was recently named a board member of the Specialty Contractors Committee of the Associated General Contractors of America, and will attend the AGC Joint Contractors Conference November 6 – 8, 2019 in Tuscon, AZ.

Kevin Peartree is now a member of the Board of Directors for The Builders Exchange of Rochester, NY.

Tim Boldt is authoring a new chapter on the ConsensusDocs Standard Short Form Agreement between Constructor and Subcontractor for the 2020 Cumulative Supplement to the ConsensusDocs Contract Documents Handbook, published by Wolters Kluwer.

John Dreste was approved as a mediation panelist for federal courts in the Western District of New York in the areas of construction and commercial disputes.

Brian Streicher earned admission to the state bars of New York and Washington, D.C., and was recently sworn in.

John Dreste is now admitted to practice law in Vermont to serve client needs and Todd Braggins has reactivated his law license in New Mexico.

Tim Boldt was appointed to the Mendon Public Library Board of Trustees.