CONSTRUCTION RISK MANAGEMENT REPORTER

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ContrACT

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The "Owner Hasn't Paid Me" Excuse

Two Years is Too Long

TIMOTHY D. BOLT

How many times have you used, or been on the receiving end of this statement: "I will pay you as soon as the owner pays me"? If you are the one making the statement, you are likely relying on a contract term that says your construction company is only obligated to pay subcontractors/suppliers when it receives payment from the owner. If you are the unpaid subcontractor or supplier, you likely are dissatisfied with that answer because your company did not expect that the word "when" would mean months upon months, or year upon year.

Over the past half century, New York courts have developed a strong body of case law related to enforcement of payment terms in construction contracts, including terms commonly referred to as "pay if paid" and "pay when paid". Under New York law, general contractors cannot force a subcontractor or supplier to assume the risk that an owner of a construction project may fail to pay for the work performed. Such terms, known as "pay if paid," are unequivocally void and unenforceable as against public policy.[1] General contractors can, however, use payment terms which temporarily delay payment obligations in the event that a

CONTINUED ON PAGE 3

Additional Insureds May Get Protection They Do Not Deserve

KEVIN F. PEARTREE

Rare is the contract that does not require a contractor to provide additional insured status to owners, affiliated entities, even designers. So too, contractors follow suit and require additional insured status from subcontractors and their insurers. Allowing certain others to ride on your CGL and other policies is just a cost of doing business.

There are compelling reasons for the coverage. Philosophically, an owner and its representatives should not have to suffer the consequences of a risk that a contractor is in the best position to control and avoid. Additional insured coverage can support a contractual indemnification obligation, provide and pay for a defense and do so without impacting the additional insured's owner insurance program and costs. But most contractors and subcontractors do not realize that the additional insurance coverage they provide and pay for can apply even when the fault lies solely with the additional insured. A recent case brings home this point[1].

There, Breaking Solutions supplied concrete-breaking excavation machines and personnel for a subway construction project for the New York City Transit Authority (NYCTA) and the Metropolitan Transit Authority (MTA). Breaking Solutions was required to name the NYCTA, MTA and the City of New York as additional insureds, via the latest ISO Form 20 10 additional insured endorsement or equivalent.

When Breaking Solutions' excavator struck an energized electrical cable buried below the concrete, an explosion occurred injuring a NYCTA employee. A personal injury lawsuit followed, involving all parties. The City, NYCTA and MTA each sought defense and indemnification as named additional insureds under the policy issued for Breaking Solutions by its carrier, Burlington Insurance Company. Burlington provided the defense subject to a reservation of rights on the issue of whether the explosion and injuries were caused by Breaking Solutions' acts or omissions. The additional insured endorsement provided coverage only to the extent that the additional insured's liability was caused in whole or in part by the acts or omissions of Breaking Solutions or those acting for it. The critical issue was whether NYCTA or MTA were entitled to coverage as additional insureds.

Discovery showed that while Breaking Solutions' excavator caused the explosion, there was no fault or negligence by Breaking Solutions or its operator who were unaware of the electrical cable. Rather, NYCTA, which was required to identify any underground hazards, failed to identify, mark, protect or shut off the power to the buried cable, leading to the explosion. Burlington then disclaimed coverage for NYCTA and MTA, and commenced a declaratory judgment action seeking a determination that no coverage was owed to them.

Burlington argued that there was no coverage under the additional insured endorsement because there was no evidence that the explosion resulted from any negligence or fault of Breaking Solutions, and therefore the employee's injuries were not caused by any acts or omissions of Breaking Solutions. A lower court agreed, citing *Crespo v. City of New York*,[2]

CONTINUED ON PAGE 2

IN THIS ISSUE

CONTINUED "ADDITIONAL INSUREDS MAY GET PROTECTION THEY DO NOT DESERVE"

which held that an additional insured's right to indemnification could not be determined without first determining whether the loss was caused by negligence of the named insured.

The appellate court reversed, finding that both NYCTA and MTA were additional insureds under Breaking Solutions' policy. The *Burlington* court distinguished *Crespo* noting that the relevant policy provided coverage "only to the extent that [the additional insured] is held liable for [the named insured's] acts or omissions." This language suggested that some wrongful conduct on the part of the named insured must provide a basis for imposing liability on the additional insured.

In contrast, the policy language in *Burlington* required only that the loss was "caused, in whole or in part," by an act or omission of the named insured. Because Breaking Solutions' *act* of striking the electrical cable caused the explosion, coverage was triggered, even though there was no negligence or wrongful conduct on its part. In the end, a risk that the owner was contractually required to identify, control and avoid – and did not – was borne by the contractor's insurance carrier, with all the resulting impacts to the contractor's insurance program and premiums.

It is difficult to reconcile the seeming conflict between anti-indemnification statutes, such as New York's[3] that prohibit an owner from requiring a contractor to indemnify it against the owner's own negligence, and the contractual obligation to obtain insurance, including additional insured coverage, that can effectively indemnify the owner for its own negligence. Short of legislation, that conflict will persist.

While it does, contractors and subcontractors should work with their insurance consultants to understand the additional insured coverage they provide and, if possible, narrow it to avoid the result that befell Breaking Solutions. Ideally, the additional insured coverage should require some demonstration of fault or negligence on the part of the named insured contractor or subcontractor. This should be coupled with a contractual indemnification provision that is limited to the extent a loss is caused by the negligent acts or omissions of the contractor or subcontractor. While the reality of a hard bid project might mean a contractor has no choice but to accept this risk, if possible contractors should negotiate a narrower additional insured endorsement. E&D

1 *Burlington Ins. Co. v. New York City Transit Auth.*, 132 AD3d 127, 14 NYS3d 377 (1stDept. 2015).

2 303 AD2d 166, 756 NUS2d 183 (1st Dept. 2003).

3 New York General Obligations Law §5-322.1.

Scaffold Law Case Round Up

NELL M. HURLEY

New York Labor Law's safety provisions, the so-called "Scaffold Laws," continue to generate a large volume of court decisions, as jurists, attorneys and the construction industry grapple with the meaning of the laws as they are applied to each fact-specific case. Here are some highlights of recent cases:

Cardenas v. BVM Construction Co.[1]
Workers hoisted one end of a heavy steel beam about fifteen feet to the scaffold on which another worker was standing. After the other end of the beam was connected to one side of the structure, the hoist was removed, with the other end of the beam resting on the scaffold. The worker on the scaffold lifted that end of the beam about 1.5 feet to connect it to the other side of the structure, injuring his back.

The court upheld the dismissal of the worker's claim under Labor Law §240(1)'s strict liability provisions because the injury was not caused by the "pronounced risks arising from construction worksite elevation differentials." Since the worker was injured while lifting a heavy object and the accident was "not caused by the types of elevation-related hazards" that are the subject of the statute, the court found the claim was not subject to the Scaffold Law provisions.

Militello v. Landsman Development Corp.[2]
While located on a mobile scaffold, a worker lost his balance while trying to apply a screw to a building. The worker fell backwards onto a "riser" of the scaffold, which impaled him in the buttock. The worker never fell to the ground but was left dangling on the scaffold.

The court held that the strict liability provision of Labor Law 240(1) applied to the accident because it was caused by the failure of a scaffold while the worker was at a height even though he did not fall to the ground. However, the court found issues of fact that precluded summary judgment for the worker, including whether the scaffold provided proper protection and whether the failure to lock the scaffold's wheels was the sole proximate cause of the accident.

Quiros v. Five Star Improvements, Inc.[3]
A worker using a nail gun to install a new roof was injured when a nail ricocheted and penetrated his eye. He brought a lawsuit for negligence based upon Labor Law § 241(6), claiming that he was not provided with adequate eye protection as required under a certain New York regulation.

The court held that the regulation properly applied to the accident, finding that the dangers that a nail gun presents to the eyes are more apparent than the dangers of manual hammering. However, the court refused to grant judgment to either side because there were issues of fact as to whether there was a violation of the regulation and whether the worker was comparatively negligent. The court noted that even if a violation of the regulation is found, it does not establish negligence as a matter of law but, instead, is only some evidence of negligence. E&D

1 133 A.D.3d 626 (2d Dept 2015).

2 133 A.D.3d 1378 (4th Dept 2015).

3 134 A.D.3d 1943 (4th Dept 2015)

Surety Cases Impacting Contractors

MARTHA A. CONNOLLY

Payment and performance bond sureties frequently challenge their obligation to perform under bonds based on the claimant's failure to comply with the bond terms or by asserting the bond principal's defenses. Courts require a claimant's strict compliance with conditions precedent, the absence of which will discharge a surety's obligations under the bond. Similarly, reliance on a bond principal's defense may also extinguish a surety's liability under the bond. Two recent cases highlight sureties' efforts to be released from liability and how contractors and owners can be impacted.

MG Hotel, LLC v. Bovis Lend Lease, LMB, Inc.[1]
For the construction of a Marriott Residence Inn in NYC, the plaintiff developer hired a construction manager, who in turn hired an HVAC subcontractor for installation of heat pump air conditioning units specifically chosen by the developer and supplied by Trane. Vigilant Insurance Company, as surety, issued a performance bond for the HVAC subcontractor naming both the developer and the construction manager as obligees. When issues arose with the Trane units, the developer sought recourse under the Vigilant performance bond and ultimately brought an action against the construction manager, the HVAC subcontractor, Trane and Vigilant.

According to the bond, Vigilant was only answerable for its principal's default where either of the obligees had declared the principal to be in default, in breach and/or to have failed to perform under the Subcontract. Vigilant moved for summary judgment dismissing the developer's claim for breach of the performance bond on the grounds that there was no evidence of the HVAC subcontractor's default or breach. To the contrary, the evidence overwhelmingly supported the position that the HVAC subcontractor's installation of the units was performed according to the contract specifications. Not only had the developer, its architect and the construction manager approved and accepted the HVAC subcontractor's work "as 100% completed and installed 'in accordance with [plaintiff's] Contract Documents", but the developer had certified in its requisitions to its lenders that no default had occurred and work was performed in accordance with approved plans.

Vigilant argued that a default or breach by its principal, the HVAC subcontractor, was an express condition precedent to its liability under the bond and that the developer had not (and could not) satisfy this condition. The court agreed with Vigilant finding no evidence of the principal's default or any deviation from the contract. The court further noted that where an owner or developer has certified that a contractor's work was completed in accordance with the contract documents, summary judgment is properly granted for the surety, and the developer's claim was dismissed.

ACS Systems Associates, Inc. v. Safeco Insurance Co. of America[2]
Plaintiff was an unpaid subcontractor on a school renovation project that made a claim on the general contractor's payment bond, issued by the defendant surety, Safeco. There was no dispute that the School Construction Authority (SCA) paid the general contractor for the subcontractor's work, or that the general contractor failed to pay the subcontractor.

Under General Municipal Law §106-b(2), a general contractor is required to promptly pay its subcontractors within seven days after receipt of payment from a public owner, but may deduct from those payments "an amount necessary to satisfy any claims, liens or judgments against the subcontractor....which have not been suitably discharged." Safeco adopted its principal's position that payment could be withheld from the subcontractor based upon a potential claim for liquidated damages that the SCA might assert against the general contractor for delays on the project, which presumably the general contractor intended to pass on to the subcontractor.

The court held that a potential claim by the SCA against the general contractor was not a claim for damages against the plaintiff subcontractor that would justify an offset in the payment due to the subcontractor. Thus, the general contractor had failed to pay promptly under the General Municipal Law. The subcontractor was awarded damages in the amount of $1,502,964, plus $399,421.77 in interest, making the decision by the surety not to pay the claim a very expensive decision indeed. F&D

1 133 A.D.3d 519 (1st Dept 2015).

2 134 A.D.3d 413 (1st Dept 2015).

CONTINUED "THE 'OWNER HASN'T PAID ME'"

project owner fails to make payment. It is within this context that the United States District Court of the Eastern District of New York, recently considered how long is too long.

In *Conviron Controlled Environment v Arch Insurance Company*,[2] Conviron (a subcontractor) completed its scope of work for a general contractor on a public improvement project. Despite completion, payment was not promptly made because the public owner did not accept and approve the work. Pursuant to the subcontract, Conviron agreed that "final payment of the balance due of the contract price shall be made to the Subcontractor:...(b) within twenty (20) days after receipt by the Contractor of final payment from the Owner for such Subcontractor's Work."

Unfortunately for Conviron, the owner, despite receiving notice from the general contractor that Conviron's work was complete, and despite taking part in a punch list inspection, refused to give the general contractor written acceptance of the work and also refused to make final payment of sums due to the general contractor.

The question presented to the Court was whether Conviron could be continually denied payment based on a *pay when paid* term which merely fixed the time for payment to Conviron and which did not permanently shift the risk of non-payment onto Conviron. The Court's answer was a resounding no.

The Court held that *pay when paid* terms must be construed "as allowing a general contractor to postpone payment to a subcontractor only for a reasonable period of time after the completion of the subcontract work" and further held that "more than two years" was unreasonable. F&D

1 *West-Fair Elec. Contractors v. Aetna Cas. & Sur. Co.*, 87 NY2d 148 [1995]

2 2:14-cv-2030 (E.D.N.Y 2015)

NEW YORK
180 Canal View Boulevard
Suite 600
Rochester, New York 14623

Visit us online at:
WWW.ERNSTROMDRESTE.COM

Ernstrom & Dreste 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's website (ernstromdreste.com).

FIRM NEWS

Chris Beirise of The Kenrich Group and Ernstrom & Dreste are offering two complimentary presentations on May 11 and 12 - *Project Document: Ensuring Project Documents Are Claims Ready* and *Schedule Delay Analysis: Demystifying the Black Box*. Please contact Mary Guyette, MGuyette@ed-llp.com for details.

Ernstrom & Dreste, LLP is pleased to announce that John W. Dreste, Todd R. Braggins, Martha A. Connolly and Kevin F. Peartree have been named 2015 New York Super Lawyers. Timothy D. Boldt and Thomas K. O'Gara have both been named 2015 New York Super Lawyer Rising Stars.

On May 18th, Kevin Peartree, Martha Connolly and Tim Boldt will teach the class *Controlling Risk in Construction and Project Delivery Systems* for the AGC Future Construction Leaders of New York State.