CONSTRUCTION RISK MANAGEMENT REPORTER

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Time's Up! Or Is It? Limits to Limitations Provisions

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Contractor clients are regularly counseled by their attorneys to "read the contract" so that nefarious contract clauses can be recognized, and claims properly preserved and pursued. But awareness of contract provisions is just the beginning. Understanding how courts interpret and apply the contract language is equally important, as two recent New York appellate court decisions illustrate. Both courts found clearly drafted subcontract limitations on the time period to bring suit against a general contractor to be unenforceable.

In the first case[1], the subcontractor contracted with the general contractor ("GC") on a New York City School Construction Authority ("SCA") job. The subcontract provided that payment from the SCA to the GC was required before (was a condition precedent to) the GC's obligation to pay the subcontractor and also made the final SCA payment subject to all credits as determined by the SCA. The subcontract further required that any action by the subcontractor against the GC be brought within one year after substantial completion of the subcontractor's work.

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Federal Court Sets Standard for Arbitrating Claims under New York's Prompt Payment Act

MATTHEW D. HOLMES

The United States District Court for the Western District of New York has recently articulated the threshold requirements to trigger mandatory expedited arbitration under N.Y. Gen. Bus. Law Article 35-E, better known as the New York Prompt Payment Act ("PPA").[1] For a party to compel another to engage in expedited arbitration under the PPA, all it needs to do is allege a violation of the PPA and comply with certain pre-arbitration notice requirements.

This case involves a dispute between an at-risk construction manager ("CM") and its sub-contractor. Disputes arose between the parties concerning delays and defective work. After the CM commenced litigation in federal court for breach of contract, the subcontractor sent a notice under N.Y. Gen. Bus. Law §756-b claiming the CM had violated the PPA. The main allegations in the notice claimed the CM had not timely approved or denied payment applications and invoices, and had wrongly withheld payment. After the required 15 day time period passed with no resolution, the subcontractor filed for arbitration. Competing motions to stay the litigation, and alternatively to stay the arbitration, followed, culminating in the court's November 2018 decision.

Under the PPA, a contractor, "[u]pon delivery of an invoice and all contractually required documentation ... shall approve or disapprove all or a portion of such invoice within **twelve business days**." N.Y. Gen. Bus. Law §756-a (emphasis added). A contractor's approval "shall not be unreasonably withheld nor shall a contractor[,] ... in bad faith, disapprove all or a portion of an invoice." *Id.* "The contractor['s] . . . payment of subcontractor or material supplier's interim or final invoice shall be made on the basis of a duly approved invoice of the work performed and materials supplied during the billing cycle." *Id.* § 756-a (3)(b). Furthermore, the PPA does not impact a contractor's ability and right to withhold payment for proper reasons set forth in both the PPA and in contract.

The court here was faced with a host of issues. The subcontractor contended that arbitration of the alleged PPA violations was mandatory. The subcontractor further asked the court to compel the arbitration of all disputes between the parties, including the parties' respective breach of contract claims. The CM raised a number of counter-arguments, including that the subcontractor had not met the threshold requirements for arbitration under the PPA. In particular, the CM argued that the subcontractor was not seeking payment for approved, completed services, had not provided all contractually required documents necessary for payment, and that certain purported invoices failed to comply with the contractually required form for payment applications. Further, the subcontractor was already on notice of defaults and alleged damages exceeding the amount of its submitted payment application and contract balance.

In addition, the subcontractor sought to compel arbitration under the PPA of disputed change order requests and claims. The CM argued that expedited arbitration under the

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Experienced Attorneys Join Firm

Andrea Morano Quercia

Andrea rejoins colleagues at Ernstrom & Dreste, Of Counsel, after a career spent in a variety of positions of increasing responsibility in private practice, government and corporate environments, most recently as the Vice-President and General Counsel of a $2B aerospace and defense division of a publicly traded company. Andrea's background encompasses not only a wide range of commercial and government contract experience, including construction litigation, but also expertise in labor and employment matters, and in ethics and compliance investigations.

Andrea received her Juris Doctorate cum laude from Albany Law School and is a graduate of the Executive Business Leadership Program at The Wharton School, University of Pennsylvania.

Brian M. Streicher

Brian joins the firm as an associate attorney and commercial litigator, bringing with him extensive experience representing financial institutions in commercial and construction financing, residential financing, and bankruptcy proceedings. Brian practiced law for seven years representing financial institutions in the dynamic market of South Florida before coming to Ernstrom & Dreste, where he will litigate and practice in the areas of Construction & Surety Law, Banking, Creditors' Rights and Bankruptcy.

Brian received his Juris Doctor degree from Case Western Reserve University School of Law. E&D

CONTINUED "FEDERAL COURT SETS STANDARD FOR ARBITRATING CLAIMS UNDER NEW YORK'S PROMPT PAYMENT ACT"

PPA was not meant to address disputed and rejected change order requests and claims, particularly those that had never been invoiced. Noting that the PPA clearly states that unless otherwise stated in the Act, the terms of the parties' contract control a dispute, the CM maintained that the subcontract terms and dispute resolution procedures provided the proper vehicle for addressing those items. Finally, the CM contended that the subcontractor had no right to compel the arbitration of the CM's breach of contract claims against the subcontractor, or those of the subcontractor against the CM. These threshold issues, the CM argued, were not arbitrable, and could be and should be decided by the court.

Before addressing the arbitrability issue, the court relied on N.Y. Gen. Bus. Law §757 to invalidate the subcontract's dispute resolution clause, at least as a basis for defeating arbitration under the PPA. N.Y. Gen. Bus. Law § 757 voids any "provision, covenant, clause or understanding in, collateral to or affecting a construction contract stating that expedited arbitration as expressly provided for and in the manner established by [§756-b] of this article is unavailable to one or both parties." N.Y. Gen. Bus. Law § 757(3). The court found that the effect of the subcontract's dispute resolution clause was to make arbitration unavailable to the subcontractor unless the CM elects to proceed with arbitration, regardless of whether the subcontractor would otherwise be entitled to arbitration under the PPA. The clause could not be used to deprive a subcontractor of its right to statutorily mandated expedited arbitration under the PPA, said the court.

Turning to the issue of arbitrability, the court held that "[i]f a subcontractor alleges that the PPA was violated and satisfies the prerequisites of § 756-b (3), then the claim may proceed to arbitration where the contractor may raise any applicable defense to support its non-payment." However, only those specific allegations of PPA violations could be presented to the arbitrators to decide whether the CM did or did not comply with the requirements of the PPA. As for the arguments and defenses raised by the CM, including whether the subcontractor satisfied the requirements for a PPA claim, these could be presented to the arbitrators to decide. However, the court concluded that neither of the parties' respective breach of contract claims could be decided by the arbitrators, as there was no agreement between the parties to arbitrate such issues. Those questions would remain for the court to decide once the arbitrators had completed their obligations under the PPA.

Takeaways:

The standard for obtaining expedited arbitration under the PPA is low: merely allege a violation and comply with the notice of complaint requirements under the PPA. At that point, those allegations, and any defenses to them – including even the applicability of the PPA – will be placed in arbitration. Contractors and their counsel should view this decision as a prompt to review their contract dispute resolution provisions to determine if they comply with the PPA. If there is any language which could deprive a party of its right to compel expedited arbitration under the PPA, then that provision, if challenged, may be invalidated by a court.

Furthermore, contractors and owners should implement measures to ensure that they timely approve or deny (and provide the reason in detail for a denial) all payment applications, invoices, and other payment requests within the twelve (12) business day requirement of the PPA. This must be done even where such documents may be improper under the applicable contract. Unfortunately, the requirements of the PPA do not align with the everyday process of pencil copies and electronic submission of payment applications on construction projects in New York. Without some legislative clarity, all parties, arbitrators, and the courts will continue to struggle with how the PPA should and should not apply. In the meantime, better procedures to timely approve or deny payment requests may not save a contractor from participation in expedited arbitration under the Act, but it should place a contractor in a better position to defend itself. E&D

1 *The Pike Company, Inc. v. Tri-Krete, Ltd.*, No. 6:18-CV-06311 EAW (Nov. 20, 2018).

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The subcontractor completed its work and submitted its final invoice to the GC in 2012. By 2016, the subcontractor was still unpaid and commenced an action against the GC. The GC moved to dismiss on the grounds that the action was untimely, since it was not commenced within one year of the subcontractor's substantial completion of its work. In response, the subcontractor presented evidence that payment was delayed while the parties waited for the SCA to confirm a credit, which was not determined until 2014, and that a final change order for work performed by the subcontractor was not signed by the SCA until 2016.

The motion court granted the GC's motion, but the Appellate Division, Second Department ruled the one year limitation period unenforceable, holding that

> "[i]t is neither fair nor reasonable to require that an action be commenced within one year from the date of the [subcontractor's] substantial completion of its work on the project, while imposing a condition precedent to the action that was not within the [subcontractor's] control and which was not met within the limitations period."

The subcontractor's suit against the GC was permitted to proceed.

The second case[2] also involved the appeal of a GC's motion to dismiss on the grounds that an action by its subcontractor was time-barred under a subcontract limitations provision. That provision required the subcontractor to commence any action within six (6) months of the date

> (a) the cause of action accrued;
>
> (b) the termination or conclusion of th[e] [subcontract]; or
>
> (c) the last day [the subcontractor] performed any physical work at the [project site], whichever event occurs first.

In early 2012, a prevailing wage class action was brought by the subcontractor's workers, naming both the subcontractor and the GC as defendants. In May 2012, the subcontractor nonetheless demanded payment from the GC. The GC refused to pay, relying upon an indemnification provision in the subcontract, and advised the subcontractor that it would not pay since no payment was due until the wage action was resolved. The GC also contended that payment was not due because the owner had not yet approved a change order.

Though the wage action remained pending, in 2014 the subcontractor brought suit. The GC moved to dismiss the action as untimely, asserting that the earliest of the three possible dates from which to measure the time for the subcontractor to commence the action was in 2012, when the subcontractor last performed any physical work. The motion was granted and the subcontractor appealed.

The focus on appeal was the GC's statement to the subcontractor that no payment was due to the subcontractor until such time as the wage action was resolved. This put the subcontractor in the untenable position where it would need to commence an action to satisfy the contractual statute of limitations before the claim had actually accrued.

Relying on a 2014 Court of Appeals case[3], as well as *D&S Restoration*, the Appellate Division, First Department agreed with the subcontractor's argument that the GC's position on payment voided the shortened limitations period for commencing an action and permitted the subcontractor's action against the GC to proceed. The court noted that

> "[a] limitation period that expires before suit can be brought is not really a limitation period at all but simply a nullification of the claim."

Takeaways:

It remains true that courts are generally unforgiving when contract requirements, including shortened limitations provisions, are not met. But these decisions demonstrate that there can be exceptions to that general rule. This line of cases shows some wiggle room in situations where the limitations provision proves "unreasonable" under all of the circumstances. In particular, the courts looked to the claim's accrual date, whether the shortened limitation period will expire before the claim accrues, and whether the accrual was within the control of the one asserting the claim. It is also important to note that, in both cases, the subcontractor lost at the motion court level and an appeal was required, with its attendant time and expense. The safest course of action is to commence any action within the shortest limitation period or obtain a written agreement between the parties tolling the contractual limitation provision. E&D

1 *D&S Restoration, Inc. v. Wenger Constr. Co.*, 160 A.D.3d 924 (2d Dept. 2018).

2 *AWI Security and Investigations, Inc. v. Whitestone Constr. Corp.*, 164 A.D.3d 43 (1st Dept. 2018).

3 *Executive Plaza, LLC v. Peerless Ins. Co.*, 22 N.Y.3d 511 (2014).

Recent E&D Results in Vermont Case

On December 7, 2018, E&D obtained clarification from the Vermont Supreme Court on how differing site condition claims may be viewed in Vermont. In *W.M. Schultz Constr. v. Vt. Agency of Transp.*,[1] that court extensively examined national authority on differing site condition claims to rule on issues that had not yet been reported within Vermont courts. E&D successfully preserved an administrative agency's award in favor of its client based on differing site conditions encountered in the course of a bridge replacement project. E&D

1 2018 VT 130, 2018 Vt. LEXIS 217, 2018 WL 6427252.

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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

Kevin Peartree presented E&D's annual Construction Law Update, ***"Lessons Learned and Re-Learned in 2018"***, for the Builders Exchange of Rochester in January.

Martha Connolly and Kevin Peartree co-authored a new chapter on the Owner-Consultant Agreement for the 2019 Cumulative Supplement to the ConsensusDocs Contract Documents Handbook, published by Wolters Kluwer.

In January, Kevin Peartree presented ***"Which Standard Form Design-Build Contract is Right for You and Your Project?"*** to the Upstate New York Chapter of the Design Build Institute of America.

Tim Boldt and Kevin Peartree will attend the 100th Annual AGC Convention April 1 – 4, 2019 in Denver, CO.

In May, E&D will be presenting on ***Controlling Risk in Construction and Project Delivery Systems*** to the AGC Future Construction Leaders of New York State at a session in Rochester, NY.