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ContrACT

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Fasten Your Seatbelts: New Wage Theft Act May Cause Bumpy Ride

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As of January 4, 2022, all new private contracts, and existing contracts that are modified, renewed or amended,[1] are subject to an expansive set of laws in New York known as the Construction Industry Wage Theft Act (the "Act"). That Act is intended to ensure that workers on private projects are paid the wages and benefits to which they were already entitled under N.Y. Labor Law Article 6. Through the new § 198-e, the Act imposes joint and several liability on a contractor for any underpayment (and numerous other wage-related violations) by any of its subs, at any tier. This means that if a subcontractor or sub-subcontractor fails to pay any of its workers for wages and benefits, those parties or their representatives can look directly to the contractor for what is due – even if the contractor has properly paid its direct subcontractor. Material suppliers are not expressly excluded, so liability may extend to their violations, too. For the violating party, the look-back period is six years; the upstream party is on the hook for three years from the date of the sub's violation.

The scope of the Act is vast, and includes many recordkeeping details usually left to subs to manage including: actual hours worked, overtime/holiday pay, frequency of payment, proper deductions from wages, required written notices to employees at hiring and weekly for wage/hours issues, obtaining signed acknowl-

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New Risks: Expanding Prevailing Wage Laws to Private Projects

BRIAN M. STREICHER

The new year brought the expansion of New York's established construction prevailing wage laws for public contracts to private projects through the recently enacted provisions of N.Y. Labor Law, §§ 224-a though 224-c. Union scale wages and fringes must now be paid on any "covered project," defined as a private project where total construction project costs exceed $5 million, and at least 30 percent of that amount comes from "public funds," itself a defined term. However, the new law is complicated, full of numerous discrete exceptions and exemptions, with important decisions and guidance needed from a newly (or soon to be) appointed volunteer Public Subsidy Board ("Board")[1]. Most importantly, without further clarification or changes, many risks of non-compliance may fall unfairly on the contractor.

What constitutes "public funds" under the law is extremely broad. It includes any financial benefits provided by state and municipal entities, Industrial Development Agencies or local development corporations, direct payments from public entities, payments made by a third party acting on behalf of or for the benefit of a public entity, savings obtained from government subsidies, money loaned from a public entity on a contingent basis, and credits against repayment obligations to the public entity.[2]

Some projects won't qualify as "covered" because the funds used are not deemed "public" under the new law. Excluded from "public funds" are: benefits under certain New York City ("NYC") property tax exemptions for affordable housing; Brownfield remediation or redevelopment tax credits; incentive funds for comprehensive sewage systems; certain payments to NYC charter schools; and tax benefits for projects the length or value of which are not able to be calculated at the time work is to be performed.

As well, various specific project types are not "covered": certain one or two family dwellings, construction for certain not-for-profit corporations with revenue under $5 million, certain affordable housing projects, specific manufactured home park projects, certain projects performed under a pre-hire collective bargaining agreement, and projects performed under a project labor agreement or its equivalent.[3]

How does a contractor know whether a project is "covered" under this new law and therefore subject to prevailing wages? Details of the owner's financing arrangements, especially with public entities, are not typically known to the contractor, nor are the "total construction project costs." While the law seems to put the onus on the owner/developer to "certify under penalty of perjury" whether prevailing wages under the law must be paid, that obligation does not arise until within five days of the *start of construction*, so bids may be required before any certification. And if an owner certification of non-coverage is later found to be in error, it is unlikely the contractor will be excused from underpayment liability, including additional labor and administrative burden, fines, penalties, findings of willful violations and legal costs.[4] Likewise, public entities are supposed to identify the nature and dollar value of the "public funds" toward

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projects and whether they are excluded under the new law. But what if that doesn't happen, the value is misstated, or the conclusion is wrong? That won't stop the Department of Labor ("DOL") from seeking the wages, benefits and more from the contractor.

The Board is supposed to offer some relief from the uncertainties under the new law with its wide range of powers and responsibilities. It can: make binding and non-reviewable determinations of coverage for a project; exempt additional affordable or subsidized housing from the law; recommend and make changes to rules regarding the minimum threshold percentage of public funds, minimum dollar threshold of project costs, exemption status of work, designation of construction versus non-construction costs, and the designation of funds as public or non-public. Finally, the Board has the power to delay the implementation of the law, which many in the industry would support.

Because of the novelty and uncertainty of the law, at minimum contractors should consider the incorporation of contractual provisions in private contracts to account for potential prevailing wage and other attendant obligations. The contract should designate from the outset (pre-bid) whether it is a "covered project" under Labor Law § 224-a, and should contain an indemnification/defense provision running in favor of the contractor if the contract is misclassified. All subcontract agreements should have flow-down clauses for prevailing wage obligations, monitoring, and compliance, with enforcement mechanisms including indemnification and/or termination.

The contours of this law will continue to evolve with guidance and rulemaking from the Board (in the shorter term), the results of enforcement actions by the DOL, and with the development of case law interpreting the statute (in the longer term). Contractors and their attorneys should stay informed to best minimize risk in the process of contract drafting and performance. E&D

1 The 13 member Board is to be comprised of state agency heads, construction industry representatives, and organizations representing owners and developers, chaired by the NYSDOL Commissioner.

2 Commonly used mechanisms for these benefits include grants, below-market rate loan interest, fees and insurance, tax credits, abatements and exemptions, and forgivable loans or those allowing credits other than payments.

3 *See* Labor Law § 224-a(4) for a complete list of non-covered projects.

4 The law also requires both owner and contractor on a "covered project" to retain original payrolls, and to comply with MWBE and SDVOB goals, so an incorrect certification of non-coverage could have other ramifications on the contractor.

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edgements of receipt of notices from employees, and any misclassification of an employee as an independent contractor under the Construction Industry Fair Play Act set forth in N.Y. Labor Law Article 25-B ("Fair Play Act").

The potential cost to contractors is likewise unnerving. The Act imposes liquidated damages in the amount of the underpaid wages (thus contractor liability for double the amount of the actual underpayment), attorney's fees, interest and penalties. For notice and recordkeeping violations, there is a per diem penalty of $50 dollars per violation up to $5,000 dollars per employee. This can add up quickly where multiple employees are involved or the violation occurs over an extended time period. For misclassification under the Fair Play Act, a contractor can be liable for fines, including for the sub's willful violations, in addition to the underpayment.

Under the Act, payment may be sought by the individual employee, or by collective groups of employees, such as unions, as well as the State Attorney General. The right to payment cannot be waived or released by the worker unless it is through a union's collective bargaining agreement.

How can a contractor reduce this new risk? To start, the contractor should reinforce its prequalification process for subcontractors, reviewing each subcontractor's forms and payment processes, including its pay notices. Shore up subcontracts: specifically reference the sub's obligation to comply with the Act (a general "compliance with laws" clause is insufficient), include proper indemnity provisions for amounts incurred by the contractor for the sub's Act violations, mandate that the subcontractor "flow down" the Act obligations to its own subcontractors, require timely certified payrolls, and prohibit the use of independent contractors, requiring all labor to be employees.

The Act includes useful new provisions under the Prompt Payment Act, adding N.Y. General Business Law § 756-f, which enables the contractor to demand information regarding its sub's compliance with the Act and to withhold payment if the sub fails to comply. Consider making compliance under § 756-f a condition precedent to the contractor's subcontract payment obligation. Send the § 756-f demand at the beginning of the subcontract, at regular intervals thereafter, and before all subcontract payments (especially final payment), to ensure timely discovery of violations.

Finally, every contractor should develop a "real time" system for monitoring subcontractor compliance as much as possible both in the field and in the office. Consider taking attendance at the jobsite to document workers there for each sub. Conduct regular reviews of each sub's compliance with wage-related recordkeeping, and investigate any issues found. Yes, this is a significant additional administrative burden on the contractor, essentially adding new oversight responsibility for its subcontractors' wage-related obligations. But given the financial risks presented by violations of the Act, it is the contractor's best bet to avoid the "bumpy ride" of liability. E&D

1 Arguably this means the Act applies to contracts on which change orders are issued and Master Subcontract Agreements.

Cross Your T's: Contractor Remedies Lost for Not Strictly Following Termination Provisions

NELL M. HURLEY

It is not uncommon to have a subcontractor that isn't up to snuff, provides delayed or defective work, or otherwise makes the general contractor's progression of its contract with the owner very difficult. The frustration this creates can sometimes lead a contractor to act hastily and to its own detriment. A recent appellate court decision[1] underscores that subcontract termination provisions must be followed to the letter, including all notice requirements and any cure periods. Termination without contractually conforming notice will only be upheld in the rarest and most exceptional of circumstances.

The case stems from a 2015 subcontract for steel work between East Empire Construction, Inc. ("East Empire") and general contractor Borough Construction Group, LLC ("Borough") for a residential development in Manhattan. On May 9, 2016, Borough sent East Empire a "notice of termination" stating that the subcontract would be terminated in three days, citing East Empire for:

"failing to provide sufficient manpower, failing to meet the schedule, safety regulations and qualified workmanship for the project, failing to respond or delayed response for requests for crane usage and delayed performance and completion of the work."

East Empire was directed to cease work immediately. Although the parties negotiated for East Empire to return to work, on May 16 Borough sent an identical notice and cease work direction. Borough then retained a new steel subcontractor.

East Empire commenced suit against Borough for wrongful termination, including failure to provide the required notice and opportunity to cure the alleged default. Borough asserted various affirmative defenses, including "persistent, incurable acts of negligence and numerous safety violations" leading to the shutdown of the worksite on May 16. Borough also sought to recoup costs incurred for the replacement subcontractor. East Empire was granted summary judgment by the lower court and Borough appealed.

Unfortunately for Borough, it was indisputable that it had not followed the subcontract termination or default provisions. For termination, Borough was required to give written notice to East Empire and a ten-day period to cure the alleged defects. To use a replacement contractor, Borough was required to allow East Empire five working days from written notice to correct the alleged defects. Instead of these, Borough apparently tried to follow a separate (and inapplicable) owner termination provision contained in a subcontract rider permitting a three-day cure period, but failed to allow that cure period either.

The appellate court affirmed the lower court ruling, relying on case law holding that a party's termination is ineffective where the contract requires notice to cure and the notice and/or cure period are not allowed. The court then examined the:

"limited circumstances where despite being contractually required, notice to cure is not necessary, such as where the other party expressly repudiates the contract or abandons the performance... or where the breach is impossible to cure."

Rejecting Borough's argument that any of these exceptions applied, the court found "nothing in the record supports the conclusion that [East Empire] repudiated or abandoned the contract" or could not have addressed the deficiencies or safety violations within the ten-day cure time period. The alleged faulty steel work was the type of defective performance for which a cure provision is intended, said the court, and there was no evidence that the alleged safety defects were impossible to cure.

The court also dismissed Borough's claim for offsets based upon expenses incurred to complete East Empire's work, citing Borough's failure to comply with the subcontract's five-day notice to cure provision before it could correct East Empire's alleged deficiencies and deduct the cost from amounts due to East Empire.

When contracting parties agree on a termination procedure, courts will enforce that procedure as written. The contractor that deviates from the contract may face this irony: because it failed to do what is contractually required, the problem subcontractor will not have to answer for its failure to do what it was required by contract to do. The remedies a contractor might have enjoyed will be lost. Before taking an extreme step like termination, thoroughly read your contract before acting, and follow the applicable notice and time requirements very carefully. E&D

1 *East Empire Constr. Inc. v. Borough Constr. Group LLC*, 200 AD3d 1 (1st Dep't 2021).

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FIRM NEWS

Brian Streicher recently became a Partner at Ernstrom & Dreste, LLP. Brian is an experienced commercial litigator representing clients in commercial and construction disputes—sureties, contractors, design professionals, property owners, and construction managers.

Kevin Peartree presented E&D's annual *Construction Law Update* to the Builders Exchange of Rochester on January 20, 2022.

In May 2022, Kevin Peartree, Martha Connolly, and Brian Streicher will present on *"Controlling Risk in Construction and Project Delivery Systems"* to the AGC Future Construction Leaders of New York State at a session in Rochester, New York.

Clara Onderdonk recently earned the designation of Certified Legal Manager (CLM)® from the national organization Association of Legal Administrators, where she will begin a three year term on its Board of Directors starting in May 2022.

E&D Partner Brian Streicher