CONSTRUCTION RISK MANAGEMENT REPORTER

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ContrACT

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Lien Law Consent: Owner's Contract Disclaimer Not Determinative

NELL M. HURLEY

A large university's effort to skirt New York Lien Law liability for the work of a subcontractor on a campus construction project was found ineffective by a recent intermediate appellate court.[1]

Cameron Hill Construction, LLC constructed a building under a ground lease on land owned by Syracuse University, which supplied the building's specifications. The lease stated:

> "[n]othing in this lease shall be construed as consent or request by the [University], express or implied, by inference or otherwise, to any contractor, subcontractor, laborer or materialman for the performance of any labor or the furnishing of any material for any improvement, alteration or repair of the premises, the improvements or any part of either."

After the project was delayed, Cameron Hill and the University reached agreements for the performance of certain work and the provision of a lien waiver by Cameron Hill's subcontractor,

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The Risk of Blanket Additional Insured Coverage

KEVIN F. PEARTREE

A single word can make all the difference. For the New York court of Appeals, that word is "with". This newsletter has followed the efforts of a not-at-risk construction manager to secure additional insured coverage it thought it had from a prime contractor and its liability carrier. But the presence of that one word – "with" – denied the construction manager what most would have assumed was a given.

In *Gilbane Bldg. Co./TDX Const. Corp. v. St. Paul Fire and Marine Insurance Company*,[1] the not-at-risk construction manager's agreement with the project owner, the Dormitory Authority of the State of New York, obligated DASNY to require its contractors to name the construction manager as an additional insured on their commercial general liability policies. DASNY's agreement with the prime contractor required the same, and the prime provided a certificate of insurance *(always beware)* that did in fact name the construction manager and other required entities as additional insureds. At that point, the intent of the owner, construction manager, prime contractor and presumably its insurer, seemed clear, and entirely consistent with common practice.

But when excavation and foundation work allegedly damaged neighboring property, DASNY sued the project architect and prime contractor that performed that work. The architect in turn brought a claim against the construction manager, who tendered its defense to the prime contractor's carrier as an additional insured. Then came the denial.

The particular blanket additional insured endorsement obtained by the prime contractor from its carrier was ISO Form CG 20 33 04 13, which provides:

> WHO IS AN INSURED (Section II) is amended to include as an insured any person or organization with whom you have agreed to add as an additional insured by written contract but only with respect to liability arising out of your operations or premises owned by or rented to you.

After the lower court ruled in favor of the construction manager securing additional insured coverage, the Appellate Division, First Department reversed, finding that the blanket endorsement did not afford the construction manager coverage because there was no contract between it and the named insured prime contractor. The construction manager was not an entity *with* whom the named insured prime contractor had agreed – via a direct contract – to provide additional insured coverage.

Given the broad implications of the Appellate Division's ruling and the split among courts on how to interpret such language, it was inevitable that the question would go to New York's highest court. With two judges dissenting, a majority of the court affirmed, holding that the wording of the blanket endorsement was "facially clear and does not provide for coverage unless [the construction manager] is an organization 'with whom' [the prime contractor] has a written contract."[2]

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The construction manager might be heard to complain that the prime contractor's insurer had simply failed to heed the words of Thomas Jefferson, who said: "The most valuable of all talents is that of never using two words when one will do." Had the endorsement only lacked the word "with", it would have read: "...any person or organization whom you have agreed by written contract to add...", and the construction manager would have enjoyed the coverage it thought it had. But the word "with" was included in the endorsement, and the majority of the court, finding nothing ambiguous about the language, gave it its ordinary meaning. "Here, the 'with' can only mean that the written contract must be 'with' the additional insured."[3]

The dissent criticized the majority for disregarding the appropriate standard of review concerning barriers to insurance coverage, and for focusing on a single word "while ignoring others, thereby finding clarity where none exists."[4]

Contractors are often required to obligate their subcontractors to provide additional insured coverage for owners and architects, and subcontractors are often required to have their sub-subcontractors and consultants do the same. Either could find themselves in breach of contract for failing to obtain the required coverage, or failing to ensure their subcontractors or sub-subcontractors do the same.

No matter which side of the additional insured coin a party is on, the Court of Appeals' ruling makes clear the importance of understanding both what you are requiring and what you are required to provide. The next step is to review these issues with your insurance consultant and, if possible, avoid blanket additional insured endorsement forms with wording that creates a gap in coverage. One word can make all the difference. E&D

1 31 N.Y.3d 131 (2018).

2 *Id.* at 135.

3 *Id.*

4 *Id.* at 137.

Intended Third-Party Beneficiary Status Must Be Explicitly Stated in Contract

MATTHEW D. HOLMES

Under what circumstances should a designer's or contractor's liability for breach of contract extend to parties with whom it has no contract? This was one of the questions the Court of Appeals faced in *Dormitory Authority of the State of New York v Samson Construction Co., et. al*,[1] was called upon to address. Was the City of New York an intended third-party beneficiary of the architectural services contract between DASNY and defendant Perkins Eastman Architects, P.C.

The City, on behalf of the Office of the Chief Medical Examiner (OCME), entered into a Project Management Agreement with DASNY, pursuant to which DASNY was to finance and manage the design and construction of a forensic biology laboratory for the OCME. DASNY then contracted with Perkins for design, architectural, and engineering services.

Under its contract, Perkins agreed to indemnify and hold harmless DASNY and the "Client" the OCME, from any claims arising out of Perkins' negligent acts or omissions, and that any costs incurred by either as a result of Perkins' design errors or omissions "shall be recoverable from [Perkins] and/or its Professional Liability Insurance carrier." DASNY's contract with Perkins did not confer third-party beneficiary status on the City, though curiously its contract with the excavation and foundation contractor did.

During construction, the parties discovered that an excavation support system was improperly installed, leading to significant problems and damages to neighboring buildings, an 18 plus months project delay and $37 million in additional costs for DASNY.

The Appellate Division overturned a lower court decision against the City, noting that the City "could" be an intended third-party beneficiary of the Perkins contract because the City exercised some degree of control over various aspects of the Project and would ultimately operate the laboratory. The decision seemed to open the door to an expansion of liability for designers and contractors alike. End users often enjoy some amount of input and even control over the elements of a construction project. Should that translate to a right of direct action against designers, contractors and subcontractors with whom they have no contract?

The Court of Appeals rejected the Appellate Division's reasoning and ruled that Perkins was entitled to summary judgment. The Court noted that "[w]ith respect to construction contracts, we have generally required express contractual language stating that the contracting parties intended to benefit a third party by permitting that third party 'to enforce [a promisee's] contract with another." In the absence of such express language, such as was found in the excavation and foundation contractor agreement, the Court concluded that such parties were considered "mere incidental beneficiaries." Therefore, given that the Perkins Contract contained no such express language, the City was not an intended third-party beneficiary.

The dissent argued that the active role of the City in approving the design and budget for a facility it would ultimately operate raised questions of fact precluding judgment in Perkins' favor. But the Court of Appeals has made it very clear that in the construction context, a party cannot claim intended third-party beneficiary status unless it can point to express enforcement rights contained in the contract at issue. An owner cannot, absent an express showing of third-party beneficiary status, directly sue subcontractors, suppliers, design professionals, and other entities that it did not contract with for breach of contract. E&D

1 30 NY3d 704 (2018).

Prepared for a Performance Bond Claim?

TIMOTHY D. BOLDT

Many contractors are unsure what to expect when faced with a performance bond claim. They are not as commonly experienced, and many contractors mistakenly approach them in the same manner they would a payment bond claim, or worse yet, an insurance claim.

Unlike insurance, sureties are merely guarantors. If the surety spends money in response to a claim, the contractor is likely obligated to hold the surety harmless. Contractors must have a strategy that accounts for the complex, multi-faceted and potentially devastating aspects of a performance bond claim.

Assess The Realities of The Situation

A strategy that is limited to finding ways of proving that the owner is "wrong" may be fraught with peril for the contractor. The critical issues are much more complicated than right and wrong, and the surety's decisions will likely be based on objective third-party advice about the law, the facts, and how the claim may be perceived by a judge or jury. Good strategies are likely to come when a contractor understands the surety's options and motivations, and can otherwise answer the following questions:

1. What are the Surety's rights and obligations to the project owner under the bond?
2. What are the Surety's rights and obligations under the bonded contract?
3. What rights and obligations flow from the indemnity agreement?
4. What can be done to minimize the surety's and therefore the contractor's financial exposure?

Throughout an entire claims process, contractors should be mindful that a surety's response to a performance bond claim can be a difficult, complicated decision and that the end result may not correlate with what the contractor wants the surety to do.

Be Organized and Communicative

The best outcomes are often achieved with a strong and organized presence, a demonstrated commitment to completing the project and a dedicated effort to minimizing the surety's financial exposure. When a contractor has reason to believe that a performance bond claim will be made, it should immediately gather project records and ensure that they are organized in a manner that optimizes a quick and efficient review. This will help minimize the surety's review costs and will help both the surety and contractor evaluate defenses to the claim. In addition to being organized, communications by the contractor should be clear, direct and timely with the surety and with the project owner.

Be Ready To Post Cash or Collateral

Posting collateral is likely the only way for a contractor to truly control its own destiny when faced with a performance bond claim that a surety wants to handle differently than the contractor. In most situations, a surety has the right to settle claims as it sees fit, as long as it acts in good faith. The common exception to this is where the contractor requests that the surety litigate the claim, and posts cash or other acceptable collateral to cover any judgment rendered against the surety, including interest, costs, expenses and attorneys' fees. E&D

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Murnane Building Contractors, LLC. Later, Murnane filed a mechanic's lien based upon non-payment for work performed and then commenced a lien foreclosure action naming Cameron Hill and the University as defendants.

The University made a pre-answer motion to vacate the mechanic's lien and dismiss the foreclosure action, claiming that the lease and the lien waiver were documentary evidence that the University did not consent to Murnane's work under the Lien Law and that Murnane released any lien by its lien waiver. The lower court agreed, but the appellate court reversed and reinstated the lien and the foreclosure action. The University's lien waiver argument was rejected because Murnane's lien claims involved work performed subsequent to the execution of the lien waiver. As for the disclaimer in the lease, the court noted that although New York Lien Law Section 3 requires the owner's consent to improvements in order to confer lien rights, case law supports the inference of consent where the owner was an affirmative factor in procuring the improvement or gave assent to the improvement in the expectation that it would reap the benefit of that improvement. Terms in a lease that the tenant must make improvements have also been deemed sufficient consent for Lien Law purposes.

Indeed, the terms of the ground lease and subsequent agreements here, observed the court, showed that their entire purpose was to construct a building for the benefit of the University. Murnane was even specifically referenced in the lease as an acceptable contractor for the work. The court cautioned that those with interests in the property cannot consent to improvements and then arrange among themselves to cut off lien rights. Thus, the court held that the language of the lease disclaiming consent was not determinative since it was inconsistent with the owner's conduct. E&D

1 Murnane Bldg. Contractors, LLC v. Cameron Hill Constr., LLC, 159 AD3d 1602 (4th Dept. 2018).

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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 and Martha Connolly are preparing the 2019 annual supplement to the ConsensusDocs Contract Documents Handbook.

Todd Braggins attended the ABA Fidelity & Surety Law Committee meeting held in Santa Fe, New Mexico in May.

John Dreste attended the DRI Surety Roundtable Conference in Chicago in May.

Todd Braggins will be attending the National Bond Claims Association Annual Meeting in Pinehurst, NC in October, 2018.

Timothy Boldt will be attending the Syracuse Surety Association's Saratoga Race Track outing on August 15.