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Getting Paid in Uncertain Times

BY KEVIN F. PEARTREE

In challenging financial times more and more contractors and subcontractors find themselves struggling to get paid for work they have performed. Owner and contractor financial problems (sometimes the two go hand-in-hand) can leave the responsible contractor or subcontractor fighting for what it is due. When the money stops flowing, liens get filed, payment bond claims are made and litigation ensues.

To avoid these problems, something that is not always possible, a contractor needs to ensure positive cash flow before the first shovel of dirt is turned. Step one is obtaining project financing information from the owner. A proactive contractor asks questions before the contract is signed. *Do you have construction loan agreement? How is the owner financing the project? What funds are available for the project? What are the terms and conditions of the funding mechanism? Are sufficient funds available for change orders and scope changes? What will be the payment procedures and how will funds be disbursed?*

ConsensusDOCS provides useful tools to help a contractor make informed decisions about with whom it should do business.

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Disorganization, Defective Design May Defeat No Damage for Delay Defense

BY MONIQUE F. MAZZA

A New York court denied summary judgment to a public owner trying to rely on a no-damage-for-delay clause where owner disorganization, massive design errors, and uncoordinated changes may have caused an electrical contractor substantial delays. *Eaton Electric, Inc. v. Dormitory Authority of the State of New York*, 21 Misc. 3d 1135A (Sup. Ct. Kings County 2008).

Eaton Electric, Inc. was the electrical contractor for work on a project involving the renovation and expansion of the library at Brooklyn College for the Dormitory Authority of the State of New York. The contract between Eaton and DASNY required Eaton to complete its work by March, 2001. However, substantial errors, conflicts, and discrepancies in virtually all of the drawings and specifications issued by DASNY and subsequent uncoordinated design changes contributed to delays. As a result, Eaton did not finish its work until 40 months after the original contract period. Numerous change orders for electrical work alone were valued at $2 million and 123 requests for information were made by Eaton. Eaton submitted a claim to DASNY for the unpaid balance of its contract price plus more than $2.4 million in damages for "additional costs of labor, materials and vendors, as well as for additional job supervision, overhead and related project costs." In the subsequent lawsuit, Eaton alleged that DASNY's insufficient investigation of the project and failure to prepare proper references and specifications lead to major design errors that DASNY failed to properly resolve and coordinate. DASNY moved for summary judgment relying heavily on the no-damage-for-delay clause in its contract with Eaton. The clause barred claims for "increased costs, charges, expenses or damages of any kind ... for any delays or hindrances from any cause whatsoever ...."

No-damage-for-delay clauses are generally valid and enforceable in New York and can prevent recovery of damages for many causes of delay, even some unreasonable behavior of an owner, provided the parties contemplated such causes or delays at the time they entered into the contract. There are however, four recognized exceptions to such clauses, three of which Eaton cited to raise triable issues of fact to defeat DASNY's motion to enforce the no-damage-for-delay clause. First, Eaton argued the project delays were uncontemplated. Eaton claimed that it could not foresee DASNY's error-ridden design plans, uncoordinated design changes, and numerous work stoppages. DASNY countered that the mere existence of the no-damage-for-delay clause in the contract indicated that the parties contemplated delays. The court disagreed with DASNY, holding that the clause itself could not establish that Eaton contemplated the type of delays it encountered. The court held that the relevant inquiry to be made is whether the delays were contemplated *despite* the presence of the clause.

Eaton further argued that the delays resulted from DASNY's breach of a fundamental contract obligation, namely DASNY's obligation to "coordinate, schedule, and progress

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Understanding BIM

BY KEVIN F. PEARTREE

Few if any topics have received more discussion of late in the design and construction industries than the emergence of Building Information Modeling, or BIM. BIM is a computer software tool that employs three-dimensional, four-dimensional (time/schedule) and even five-dimensional (cost), intelligent design modeling that provides a data-rich, object-oriented representation of a project. A building information model can be an integrated project database with highly detailed information about material and structural properties for almost every element of a building. More often, there is not simply one project model but several created by the architect, contractor and various specialty contractors.

Through a BIM process, a project can be built 'virtually' before it is built in reality. The model can allow designers and contractors to more quickly and efficiently identify and resolve design conflicts. An intelligent model can run "clash reports" to determine if building components are in conflict with one another. Fewer "clashes" should translate into fewer change orders and less rework. Models also serve as useful tools for sequencing, value engineering, mock-ups and even marketing.

BIM and other new information technologies require greater collaboration among project participants to reap their full potential. A collaborative BIM process should produce better design decisions; better than those made in the traditional two-dimensional design world. This means the traditionally fragmented and too often dysfunctional approach to design and construction must change, and that is good for the industry as a whole. This change can mean uncertainty and trepidation for the more cautious: *Are the traditional lines between design and construction altered and blurred? What are the risks of sharing digital models? How are property rights affected? Who manages the process and does that lead to greater liability? Who can make changes to the model?*

Stepping up to answer these and other questions are standard forms published by ConsensusDOCS and the AIA. The ConsensusDOCS 301 BIM Addendum in particular does not require any restructuring of the contractual relationships. The addendum can be used with existing standard form owner-architect and owner-contractor agreements and maintains the lack of privity between the designer and contractor. The architect remains responsible for the design of the project. The Addendum provides a framework for structuring a federated model BIM approach, that is, a model consisting of linked by distinct component models, drawings and other data sources that do not lose their identity or integrity by virtue of being linked. A change to one component model does not create a change in other component elements of the federated model. In this way, the contributions of one project participant cannot alter another participant's component model.

The BIM Addendum provides a checklist of issues to project participants to consider as they map out their respective responsibilities and requirements, including information management, intellectual property rights and risk management.

For those looking to better understand the BIM process, an excellent place to start is The Contractor's Guide to BIM, recently published by the Associated General Contractors of America and available on its website at www.agc.org. When more people see that the recognized benefits outweigh the perceived risks of BIM, the question may become whether you increase your risk by not using a BIM approach. E&D

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the work" as required by contract. DASNY countered that Eaton's claims at worst amounted to "inept administration" and could not rise to the level of a fundamental breach. Again, the court disagreed, finding that Eaton alleged specific breaches of DASNY's contractual obligations.

Eaton also argued that DASNY acted in bad faith and with gross negligence regarding the designs and specifications. Specifically, Eaton contended that DASNY knew that the HVAC designs were deficient before the parties entered into their contract; that mechanical and plumbing drawings issued to bidders had not been coordinated with telecommunications work; that DASNY obstructed its work by prematurely occupying the library before it was complete; and that DASNY ignored serious design and adverse working deficiencies and directed Eaton and other contractors to proceed with work without proper plans and schedules. The court found that these allegations were sufficient to proceed to trial.

DASNY also tested three other defenses in addition to the no-damage-for-delay clause: (1) Eaton's purported noncompliance with written notice and dispute provisions; (2) Eaton's execution of change orders containing release language; and (3) Eaton's calculation of damages on a total cost basis. Ultimately, the court disagreed with DASNY on these defenses. As to the written notice provisions, the court found that Eaton's continuous submission of written daily reports, look-ahead schedules, progress data, and RFIs describing the delays fully apprised DASNY of the delays being encountered. The court also found that triable issues of fact existed as to whether DASNY, through its construction manager, waived compliance with notice provisions by verbally telling Eaton that DASNY would compensate it for its increased costs when the project was complete. Moreover, the court held that the dispute provision in the contract covering claims for disputed extra work did not apply, as claims for extra work and for delay damages are different. As for the release language contained in change orders, the court rejected DASNY's argument that such language barred Eaton's claims. The releases had no bearing on the delay claims asserted by Eaton, the court reasoned, because by their terms the releases related to additional compensation for extra work – which Eaton did not seek. Lastly, the court rejected DASNY's argument that Eaton's claims for damages calculated on a total cost basis must be dismissed, holding that Eaton was not required to separate those portions of its claims until trial.

This decision should be of great interest to both owners and contractors, because it reiterates that no-damage-for-delay clauses are not impermeable and can be pierced by an owner's disorganization. How these issues are ultimately resolved at trial bears watching. E&D

What's In Your Contract? The Value of Waiver of Subrogation Clauses

BY DOUGLAS A. BASS

A recent decision by New York's Appellate Division, Second Department underscores the importance of "waiver of subrogation" clauses in construction contracts. In *Gulf Ins. Co. v. Quality Building Contractor, Inc.*, 58 A.D.3d 595, 871 N.Y.S.2d 366 (2nd Dept. 2009), an architect found itself facing liability it could have easily avoided with more conscientious contract risk management.

Subrogation is the equitable doctrine that allows an insurer that has paid its insured for a loss to stand in the shoes of that insured and seek recovery – indemnification – from those parties actually responsible for causing the loss. Most property insurance policies contain language providing an express right of subrogation, giving the insurer a vehicle for recouping what it paid for a loss. An insured must be careful not to frustrate the insurer's right of subrogation at the risk of losing coverage.

A waiver of subrogation cuts off the insurer's right of recovery. In construction, waivers of subrogation are most commonly granted in connection with project property insurance coverage, including the builder's risk policy. Perhaps the most commonly encountered waiver provision is Section 11.3.7 of the AIA A201 General Conditions (2007):

> The Owner and the Contractor waive all rights against (1) each other and any of their subcontractors, sub-subcontractors, agents and employees, each of the other, and (2) the Architect, Architect's consultants, separate contractors described in Article 6, if any, and any of their subcontractors, sub-subcontractors, agents and employees, for damages caused by fire or other causes of loss to the extent covered by property insurance ….The policies shall provide such waivers of subrogation by endorsement or otherwise…

The idea behind the waiver is to shift the risk of loss away from the project participants to the insurance policy, and in the process avoid for each, the expense and risk of litigation. Insurers are more inclined to allow waivers of subrogation in the context of construction. Construction is fraught with the risk of property damage and personal injury. A typical contractor is more likely to be a defendant in such a lawsuit than a plaintiff. By allowing a waiver of subrogation, the insurer is foregoing a right that may have little value while gaining for itself protection from litigation. As the party that would ultimately pay the cost of defending such claims, the insurer enjoys the savings in litigation costs. Further, it is understood that builder's risk coverage is often obtained to include the interest of not only the owner, but the contractor, subcontractors and sub-subcontractors as well.

In *Quality Building Contractor*, a portion of a concrete roof collapsed during restoration work on an underground parking garage of an apartment building complex in Queens, New York. The property damage was covered by Gulf Insurance Company who paid the owner, Park City Tenants Corporation in accordance with the terms of its insurance agreement. Gulf Insurance then filed a lawsuit against the general contractor, its subcontractor and the project architect, as subrogee of Park City, for the damages caused by the garage roof collapse.

The general contractor, Quality Building Contractor, Inc., its concrete work subcontractor, Affordable Concrete Construction, Inc., and the project architect, Howard L. Zimmerman Architects, P.C. all moved for summary judgment asking the court to dismiss all of the claims Gulf Insurance brought in the name of Park City. The trial court denied summary judgment to all of them, refusing to dismiss the case against any.

Quality Building's contract contained a waiver of subrogation clause that read, that Park City and Quality Building "waive[d] all rights against each other for damages caused by fire and other perils to the extent covered by insurance obtained pursuant to this Article or any other property insurance applicable to the Work." On the basis of this clause, the Appellate Court reversed the decision of the trial court and dismissed Gulf Insurance's lawsuit against Quality Building.

Affordable Concrete's subcontract contained a clause granting it "the benefit of all rights, remedies and redress afforded to [Quality Building]" by the Quality Building/Park City prime contract. Included among these benefits was Park City's waiver of subrogation clause. On the basis of this clause, the Appellate Court reversed the decision of the trial court and dismissed Gulf Insurance's lawsuit against Affordable Concrete.

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ConsensusDOCS 290 - Guidelines for Obtaining Owner Financial Information, provides a contractor with guidelines and safeguards to obtaining owner financial information. ConsensusDOCS 290.1 - Owner Financial Questionnaire is a vehicle for obtaining information from an owner about what kind of entity the prospective project owner is, financial information and information to secure lien and bond rights and obtaining copies of relevant financial documents.

How an owner responds to such inquiries, whether it is accommodating or defensive, can provide reassurance to a contractor or raise red flags. Project owners that offer only vague responses, withhold information or are non-responsive altogether are to be avoided. Other sources of information can offer useful intelligence, including Dun & Bradstreet reports and reported lien, judgment and tax liability filings with county clerk offices.

The diligent contractor will also insist upon appropriate contractual rights and protections. For example, both the ConsensusDOCS *(www.ConsensusDOCS.org)* and the AIA A201 General Conditions include language providing the contractor with the ability to secure information and evidence from the Owner that there is sufficient funding available for the project. For example, ConsensusDOCS 200, the Standard Agreement and General Conditions Between Owner and Contractor (Where the Contract Price is a Lump Sum) states:

> 4.2 FINANCIAL INFORMATION Prior to commencement of the Work and thereafter at the written request of the Contractor, the Owner shall provide the Contractor with evidence of Project financing. Evidence of such financing shall be a condition precedent to the Contractor's commencing or continuing the Work. The Contractor shall be notified prior to any material change in Project financing.

While the ConsensusDOCS language is broader than the corresponding §2.2 of AIA A201 (2007) in the rights it gives the contractor to obtain updated owner financial information once the project has started, both documents are very beneficial for a contractor. E&D

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ERNSTROM & DRESTE NEWS

Kevin Peartree recently lectured on contract risk management for a class of Future Construction Leaders for the AGC of NYS.

Ernstrom & Dreste also publishes the Fidelity and Surety Reporter. If you would like to receive that publication as well, please contact Mindy Moffett at mmoffett@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).

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Zimmerman, however, was not as fortunate. Its contract with Park City did not contain a waiver of subrogation clause. Nor did it have a clause granting it the benefit of Quality Building's waiver of subrogation clause. Instead, Zimmerman argued, unsuccessfully, that it should be afforded a waiver because it claimed Park City agreed to a special "insurance plan".

Zimmerman claimed that under the terms of this "insurance plan", Park City agreed to be responsible for any damages to the "Work" as defined by the Quality Building/Park City prime contract. Presumably, Zimmerman's position was that since it believed Park City assumed responsibility to pay for any damages to the "Work", Park City would never have the right to sue Zimmerman in its own name if any damage occurred. Since Park City would never be able to sue Zimmerman in its own name for such property damage, it would follow that none of its subrogees stepping into its shoes should be able to do so either. Or so it seemed to Zimmerman. The Court rejected this argument for reasons not made clear. What the Court did make clear was that had Zimmerman included a waiver of subrogation clause in its contract, it too would have escaped the direct claims of Gulf Insurance.

A waiver of subrogation clause is an extraordinarily valuable resource for risk management. With it, you can save yourself thousands upon thousands of needless dollars in litigation costs and exposure to liability for thousands more. Without it, you may find yourself, for all practical purposes, not only being responsible for constructing the project, but for insuring it as well. E&D