CONSTRUCTION INDUSTRY NEWSLETTER

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Compliments of

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DAMAGES FOUND TO BE RESULT OF CONTRACTOR ERRORS

*Arcon Construction v. Germantown Central School District**

Contractor sought contract balance and delay damages totaling $750,000 on a renovation project. Arcon claimed that the District obstructed and interfered with their means and methods of construction resulting in out of sequence work and extraordinary overtime. However, the contract contained an explicit "no damages for delay clause" and the District had reserved its right to make schedule changes as necessary. Further any claims had to be timely made in writing. During the trial the court heard testimony of the construction manager. In a detailed analysis the court cited *Corrino Civetta v. City of New York* for the proposition that there are only four recognized exception to an exculpatory contract provision which precludes the recovery of damages for delays. The contractor failed to establish any of these exceptions, used an improper method in computing its damages, and failed to show that the district had either actual or constructive knowledge of its claims.

The court concluded that Arcon's damages were the result of its own errors in preparing its bid and its faulty underlying assumptions and projections. Their complaint was dismissed after trial.

**The School District in this case was defended by Lewis & Greer P.C. (Dan Adams)*

CONTRACTOR'S SUBSTANTIAL PERFORMANCE PREVENTS WRONGFUL TERMINATION BY OWNER

845 UN Limited Partnership v. Flour City Architectural Metals, Inc.

Owner entered into contract with Flour City Architectural Metals to install glass paneling in condominium units for Trump Towers in New York City. Owner sued contractor for breach of contract for failing to complete the work as stipulated in the contract and contractor counter claimed. Under common law, a party could recover on a contract only if he exactly performed what was required under the contract. In construction contracts today, under the doctrine of substantial performance, a contractor is allowed to recover from the owner when he has done very nearly what the contract calls for. These decisions have been left to the courts to determine what constitutes substantial performance.

The trial court awarded the contract balance of $1 million dollars to the contractor but also awarded $424,000 to the owner for breach of contract for the incomplete units. Upon appeal the court found and held that the

undisputed evidence of substantial performance, based on testimony of employees of the owner's agent, vitiated the owner's right to terminate the contract. They therefore reversed and remanded for a new trial.

DAMAGES BASED ON OBLIGATION TO PAY THIRD PARTY EVEN THOUGH NO PAYMENT HAD BEEN MADE

GCM Metal Industries vs. J&B Contracting Co. Inc.

Can a subcontractor require that a proffered contract be limited to the scope of work originally bid on? A judge in civil court in Brooklyn says yes. Here the sub had received a confirmation letter from the contractor which contained a description of the work that differed from the bid proposal. The sub deleted the additional work. Later, after incurring $14,000 in expenses for the preparation of shop drawings, they were terminated. At the trial they were told they were terminated because of non-approval by the NY Dormitory Authority.

The trial judge not only found that the allegations of non-approval were without foundation, but also found that the contractor had interfered with the subs performance. "A party to a contract cannot rely on the failure of another to perform a condition precedent where he has frustrated or prevented the occurrence of the condition."

SUBCONTRACTOR DENIED INDEMNIFICATION FOR NONCOMPLIANCE WITH SPECS

Gap Inc. v. Fisher Development Inc.

Indemnification protects contractors and subcontractors against liability for claims where the wrongful or negligent acts were caused by others. Indemnification provisions are normally incorporated into construction contracts. In the absence of such an agreement in the contract, a party can be compensated for loss based on common law. In such an instance, liability for injury is placed on the party who actually causes the injury, as opposed to the person who is liable because of his relationship to the guilty party, but did not actually cause the injury. In a recent case, the question arose whether a subcontractor was entitled to indemnity from its sub-subcontractor, in the absence of an indemnification clause. General contractor, Fisher Inc. entered into a contract for The Gap chain of stores and subcontracted the installation of the HVAC system and hot water pipe construction to Kaback Enterprises. Kaback then entered into a sub-subcontract with Alpha Mechanical Corp. to supply the hot water piping and the installation-- with clear instructions that installation should be completed "as per plans and specs." A subsequent leak, resulting from the fracture of a corroded drain valve cap, caused substantial property damage. The store sued the general contractor, subcontractor and sub-subcontractor for negligence and breach of contract. Investigation found that Alpha had failed to insure that the proper materials had been installed, directly causing the leak.

The trial court upheld the jury's verdict that Alpha breached its sub-subcontract with Kaback, Kaback breached its sub-contract with Fisher and Fisher breached its contract with Gap. The trial court also reversed the jury's ruling and found Alpha to have been negligent in installing substandard materials. On appeal, the court overturned the trial's court's ruling on Alpha's negligence-- deciding that although there was evidence of breach of contract, the installation of the substandard materials was not Alpha's fault. Indemnification for injury to persons or property is only allowed when the party seeking compensation did not participate in the acts giving rise to the injury. Kaback's own participation in the acts as a wrongdoer precludes it from recovery against Alpha.

SUBCONTRACTOR'S RESPONSIBILITY EXTENDS TO ENTIRE WORKSITE

Velasquez v. Biltmore Construction Corp.

Plaintiff sued to recover for personal injuries sustained while working on a construction project for defendants, alleging violations of the Labor Law. Defendants, contractor and subcontractor moved to dismiss the complaint, arguing they neither created nor had notice of the condition causing plaintiff's injury. The general contractor, BRF Construction further contended it was not liable because plaintiff was not entitled to protection under the Labor Law. Defendants do not dispute, however, that the owner and general contractor hired plaintiff to work on defendant's site, as is necessary for Labor Law protection. Plaintiff was ordered by the site's foreman to lay salt on snow and ice covering a pedestrian walkway adjacent to construction site also used by workers.

The court ruled that as long as plaintiff's work related to the work of the defendant owner or its agents by whom he was hired, and it was part of their construction project, he was a worker covered by the Labor Law. The court determined the contractor was also liable for injuries caused by the hazardous condition in the area of the work delegated to the subcontractor and over which it had authority. A contractor's lack of control over the work assignment does not render the safety regulation inapplicable to its work area. Therefore, it was negligent in failing to provide a clear, secure passageway or for erecting a barrier guarding against passage over an unsafe area. The court denied defendant's motion to dismiss plaintiff's claim under Labor Law Section 241.

NOTICE OF MECHANIC'S LIEN DISCHARGED

Fountainview at College Road Inc. V. Pearl River Plumbing Heating and Electric Inc.

Section 17 of the Lien Law operates as a statute of limitations and sets forth the procedure for filing a mechanic's lien. No lien specified in the article shall be a lien for longer than one year after the original notice of a lien has been filed with the proper office, unless within that time an action is commenced to foreclose the lien or an extension to the lien has been filed. However, if an action is not commenced within the one year period the owner of the property can then bring on a proceeding to discharge the lien. In this case, the owner argued that the subcontractor had not filed a notice of pendency within the required one year period. The subcontractor, alleged he was incapable of filing either an extension or a notice of foreclosure on the lien due to a Bankruptcy Court stay of proceedings against the contractor who employed him. However, the Bankruptcy Code and the CPLR sets forth the principle that an owner of real estate cannot prevent the enforcement of a mechanic's lien. The subcontractor, therefore, cannot claim it is bound by the contractor's Bankruptcy Court stay of proceedings in order not to foreclose the lien in a timely manner.

The court found that the sub-contractor could have foreclosed it's mechanic's lien or lengthened its duration by following procedures for filing an extension of such lien.

SUBCONTRACTOR BOUND BY LIMITATIONS PERIOD IN PAYMENT BOND

Techcon Contracting, Inc. v. Incorporated Village of Lynbrook

Carlo Lizza & Sons Paving, Inc. was retained as a subcontractor by Techcon Contracting, Inc. to perform grading and paving work in the Town of Lynbrook. Lizza Paving suspended work on July 31, 2002 alleging it had not been paid by Techcon for any of the work it had performed prior to that date. Lizza Paving sought to recover under the payment bond issued by Lincoln General. Lincoln General argued that Lizza Paving's claim was time barred by the statute of limitations contained in State Finance Law Section 137 and by the terms of the contract between Techcon Contracting Inc. and Lizza Paving. Section 137 of the State Finance Law states that no action on a payment bond shall be commenced after the expiration of one year from the

date on which final payment owed the subcontractor became due. Lincoln General asserted that the day that Techcon was terminated by Lynbrook for failure to perform the work in accordance with the terms of their contract is the day on which Lizza's final payment was due.

The court determined that Lincoln General had failed to prove the date upon which Lizza's final payment was due. So the motion for judgment based on the State Finance Law Section 137 was denied. Lincoln General further asserted that if Lizza's claim was not barred by the State Finance Law it was time barred by the terms of the contract between Lynbrook and Techcon. The contract stated that no claim may be maintained more than one year after the principal, Techcon, ceased work on the project, regardless of cause. Techcon was terminated on September 23, 2002. Lizza Paving's actions was commenced more than one year from the date upon which Techcon ceased work on the contract. Therefore, its claim against Lincoln General was time barred according to the contract and its action to recover payment was dismissed.

CONTRACT LANGUAGE PLACES COSTS OF INDEMNIFICATION ON CONTRACTOR

Trano v. Federated Department Stores, Inc.

Owner entered into two agreements with 4 Star Contracting, under the terms of which 4 Star was to remove, replace and cover all expansion joints on the sidewalk of a shopping center. Approximately one month after completion of work on the project, the plaintiff tripped and fell on an expansion joint, sustaining injury. The indemnification clause in the agreement stipulated that the contractor agreed to indemnify the owner from all claims for personal injury and property damage alleged to arise out of the work performed under the agreements. Based on the indemnification clause, the owner therefore demanded that 4 Star reimburse them for the costs incurred in defending the personal injury action. When 4 Star refused, the owners turned to the courts to enforce the provisions contained in the agreements. The owners also sued 4 Star for breach of contract for its failure to procure insurance naming the owners as additional insureds, as was required by the agreement.

The court ruled in favor of the owners and required 4 Star to indemnify the owners for the costs incurred in defending the personal injury claim. The courts also found 4 Star in breach of contract for its failure to obtain the required insurance protecting the owners. Since Ms. Trano alleged in her lawsuit that her injury arose out of 4 Star's work, the contractor was specifically required to indemnify the owner pursuant to the provisions of their contract.

ERROR DOES NOT PLACE FIRM AT COMPETITIVE DISADVANTAGE

Terra Firma Electrical v. City of New York Department of Environmental Protection

Public bidding laws serve two primary purposes. They primarily benefit the public by enabling municipalities or public agencies to obtain the best price for public improvement contracts through competitive bidding. They serve as well to insure that contractors bidding on public projects are on an equal footing in competitive bidding. Bid specifications, such as bidder qualifications, specifically insure that no contractors are given an unfair advantage and must be strictly adhered to. It follows that bids which do not comply with the proper bid specifications may be rejected. However, in the event of non-compliance the judgment must be made as to whether to reject the bid on the ground that the non-compliance is material or to accept the bid for the reason that the defect is a mere irregularity. Terra Firma Electrical and Schlesinger Siemens, LLC submitted bids for improvements to a water pollution control plant in Brooklyn. Schlesinger's bid was originally rejected as it had submitted the wrong bid sheet. Schlesinger was granted an appeal to correct its error, reducing its bid by an additional $400,000. Terra Firma filed a protest claiming that the error constituted a material non-compliance with the specifications and that Schlesinger should not be allowed to correct its mistake.

The commissioner rejected the protest and upheld the deputy commissioner's determination to permit Schlesinger to correct its bid. The court later agreed with the deputy commissioner, holding that the technical non-compliance was a mere irregularity and it was in the best interest of the City of New York to accept the lower bid. The error was not determined to place Terra Firma at a competitive disadvantage, as Schlesinger's bid was at all times, lower than Terra Firma.

PROHIBITION ON PAY-IF-PAID CONTRACTS DID NOT OVERRIDE PARTIES' CHOICE OF LAW

Welsbach Electrical Corp. v. MasTec North America, Inc.

The Court of Appeals of New York ruled that although state law prohibits pay-if-paid contracts, the public policy supporting the law is not so fundamental that the statute trumps the parties' decision to apply the law of a state that allows such contracts.

Telergy Metro retained MasTec North America, Inc. to build a fiber optic telecommunications network in New York. Telergy was a Florida corporation and MasTec is a Delaware corporation. MasTec subcontracted with Welsbach Electric Corp. to do the electrical work for the project. The subcontract included a pay-if-paid clause. Termination, suspension or delay of the primary contract between Telergy and MasTec automatically terminated, suspended or delayed the subcontract on both the same basis and effective date. In the event of termination, suspension or delay, Welsbach had the right to recover from Telergy amounts payable to MasTec less any anticipated gross profit from the work. Florida law governed the contract.

Telergy became insolvent and terminated its contract with MasTec. The subcontract terminated automatically. Welsbach sued MasTec for unpaid amounts due under the subcontract. MasTec asserted two affirmative defenses: 1) Florida law enforces pay-if-paid provisions, and MasTec never received payment from Telergy and this owed no money to Welsbach, and 2) Welsbach could seek recovery only from Telergy, pursuant to the contract's termination provision.

Welsbach countered with motions for partial summary judgment and dismissal of the affirmative defenses. The subcontractor argued that the subcontract's pay-if-paid clause violated New York law, which prohibits such contracts.

The trial court held that although pay-if-paid clauses are enforceable in Florida, they violate New York law. The court struck the affirmative defense and an intermediate appeals court affirmed. The Court of Appeals of New York disagreed. The policy considerations underlying the statue prohibiting pay-if-paid contracts do not "embody a concept…fundamental to our law…" Fundamental principles in this context include things like human and civil rights protections and outlawing discrimination based on race or creed. Additionally, both MasTec and Welsbach are sophisticated commercial entities that knowingly and voluntarily entered into the subcontract. Neither company is a New York corporation. "Considering these factors and given the checkered history of pay-if-paid clauses in the construction industry, we cannot say they are 'truly obnoxious' so as to void the parties' choice of law." The Court of Appeals explained.

ANNOUNCEMENTS

The American Arbitration Association has appointed J. Scott Greer, Esq. to its National Roster of Neutrals for Commercial and Construction Disputes. Mr. Greer is a member of the law firm of Lewis & Greer, P.C., Poughkeepsie, New York and has provided legal services to the construction industry for more than 22 years. The American Arbitration Association is the nation's largest full-service alternative dispute resolution provider.

Experience in providing legal services and advice on a wide variety of issues and matters arising in the construction industry. The firm represents owners, architect/engineers, construction managers, general contractors, material suppliers, specialty subcontractors, and surety and bonding companies with regard to projects in both the private and public sectors. The firm currently provides legal services for construction projects throughout the Northeastern states and internationally as required by the needs of our clients.

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