CONSTRUCTION RISK MANAGEMENT REPORTER

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ContrACT

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Court Solidifies Labor Law §240 Liability for Construction Manager/Agents

A split decision by New York's highest court has reaffirmed and expanded the potential liability of construction manager/agents for New York Labor Law §240 claims. New York's "Scaffold Law" is notorious in the construction industry for the vast amount of litigation it has generated and the near-absolute liability it imposes on "contractors and owners and their agents" for height-related safety risks. Many construction managers in New York may be operating under the belief that they are sufficiently insulated from such liability. The New York Court of Appeals' 4 to 3 decision in Walls v. Turner Construction Co., 4 N.Y.3d 861, 831 N.Y.S.2d 408 (2005), should quickly dispel that mistaken belief.

Turner contracted to be a construction manager/agent for the Massapequa Union Free School District. When a special employee of a trade contractor was injured in a fall, he brought suit under Labor Law §240 against Turner as construction manager. After the trial and appellate courts each found Turner to be a statutory agent of the school district

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Pay-if-Paid Re-Loaded: A Decade in Review

The concept of pay-if-paid remains a source of bitter disputes in the construction industry. A typical pay-if-paid contract provision is intended to prevent a general contractor's obligation to pay its subcontractors from arising until the general contractor receives payment from the owner.

If the general contractor never receives payment from the owner, so the theory goes, the general contractor's obligation to pay the subcontractor never arises. The reason pay-if-paid clauses were conceived was to protect general contractors from becoming stuck between the owner's unjustified refusal to pay on the one hand and the subcontractor's legitimate demands for payment on the other.

In 1995, New York's highest court voided pay-if-paid clauses in the now well-known *West-Fair*[1] decision, as part of what seems a national trend of outlawing the pay-if-paid provision. Ten years and several court decisions later, the rule in New York is, perhaps, less clear than it first seemed. The court in *West-Fair* reasoned that pay-if-paid provisions violated the N.Y. Lien Law's prohibition against advance lien waivers. Enacted in 1975, § 34 Lien Law provides that a person providing labor, material or services to a construction project cannot waive his or her lien rights in advance. Any attempt to obtain such a waiver, typically in the form of a provision in an agreement, is deemed void as violating New York's public policy. The court in West-Fair held that since a pay-if-paid provision theoretically barred a subcontractor's right to receive payment, it also prevented recovery on a lien theory. As a result, the court decided that pay-if-paid provisions violated the New York policy against advance lien waivers. Where a subcontract contains a pay-if-paid clause, the court reasoned, a subcontractor is effectively agreeing to waive its lien rights the moment he or she signs the contract. Importantly, the Court of Appeals also decided that a contract which delays payment for a "reasonable" time, but not indefinitely, is permissible under the Lien Law. Naturally, the Court provided no insight as to what period of time is "reasonable."[2]

A problem with *West-Fair* is that it makes general contractors the guarantors of payment in the construction process. The typical pay-if-paid provision was never intended to create a waiver of lien situation. In the face of *West-Fair*, new contract language has been created which attempts to address this very issue. The language comes in several different forms but in essence provides that where the owner fails to pay the prime contractor, a subcontractor must pursue and exhaust its lien remedies before turning to the prime contractor or the contractor's payment bond to seek payment.

Late last year, the Appellate Division's Third Department in *J&K Plumbing & Heating Co. v. William H. Lane, Inc.*, 13 A.D.3d 856, 786 N.Y.S.2d 253 (3rd Dept. 2004), confronted a general contractor's attempt to contract around *West-Fair's*

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Risk Management Briefs

NO WRITTEN NOTICE, NO CLAIM

If anyone needed a reminder of the importance of strictly complying with contractual written notice of claim requirements, a New York appellate court has recently provided it. Reiterating what should by now be axiomatic, the New York Appellate Division, Third Department, in *Kingsley Arms, Inc. v. Sano Rubin Construction Company, Inc. et al,* 16 A.D.3d 813, 791 N.Y.S.2d 190, held that a subcontractor's failure to strictly comply with condition precedent written notice provisions amounted to a waiver of its breach of contract claim. Arguments by the subcontractor that the construction manager/general contractor was aware, from oral conversations, of the delays giving rise to the claim were to no avail. The result might have been different had the subcontractor shown that the construction manager/general contractor waived the written notice of claim requirement. But without proof of the details of the alleged oral conversations, the subcontractor had too little on which to base its case.

Ignore condition precedent notice of claim requirements at your own peril. When time and money are at stake, do not rely on oral conversations; put it in writing.

CERTIFICATE IS NO PROOF OF COVERAGE

Still too many general contractors continue to rely upon a certificate of insurance as proof of additional insured coverage under a subcontractor's general liability policy, and always to their detriment. From the New York Appellate Division, First Department, comes yet another decision driving home the point that a certificate of insurance is not proof of actual coverage. The Court in *Insurance Corporation of New York v. U.S. Underwriters Insurance Company, et al.*, 11 A.D.2d 235, 782 N.Y.S.2d 432 (1st Dept. 2004), held that a certificate of insurance naming a general contractor as an additional insured is not, by itself, sufficient to raise a factual issue as to the existence of coverage. A general contractor must present 'additional factors' substantiating coverage. The court's ruling underscores a line of cases in New York holding that a certificate of insurance is evidence of the insurer's intent to provide coverage, but it is not a contract to insure, nor is it conclusive proof, standing alone, that such a contract exists.

Always demand and obtain a copy of the policy including the additional insured endorsement to the policy, before the subcontractor starts any work.

PRECISION DRAFTING

When it comes to crafting solid contractual language, the New Court of Appeals offers one more lesson in *Tonking v. Port Authority of New York*, 3 N.Y.3d 486, 787 N.Y.S.2d 708, 821 N.E.2d 133 (2004). In *Tonking*, a general contractor's indemnification obligation extended to the Owner and its agents, but did not specifically reference the "construction manager". The construction manager was not "at risk" but an agency construction manager. Despite over 130 references to the "construction manager", no where was the construction manager referred to as the "agent" of the owner. As a result, the Court found that the construction manager/agent did not qualify as an "agent" covered by the general contractor's indemnification obligation.

If a construction manager wants the added protection of indemnification and the status as an additional insured, it should say it unambiguously throughout the construction management and general trade contracts.

By Kevin K. McKain and Gavin M. Lankford

CONTINUED "PAY-IF-PAID RE-LOADED"

prohibition on pay-if-paid in *West-Fair*. The contract in *Lane* required the subcontractor to "exhaust" its lien remedy against the property *before* pursuing the contractor for payment. Conceptually, this would provide the contractor with some protection, because in the event that the subcontractor's lien resulted in payment from the owner or from the real property, the contractor would not be required to come out of pocket. If the subcontractor failed to pursue the lien claim, then the contractor would arguably be excused from its payment obligations to the subcontractor. However, if the subcontractor pursued the lien claim and still was not paid, then the general contractor would be faced with the obligation. The Third Department decided that Lane's contract language "impermissibly transfer[red] the risk of [the owner's] failure to pay from Lane to the subcontractors." As a result, the court rejected Lane's argument that its contract provision was a mere "time for payment" provision, which the *West-Fair* court held enforceable.

A similar provision has also been rejected by the Supreme Court, Albany County. In an unreported decision[3], the court summarized the contract provision as follows: "Essentially, this provision provides that in the event the owner fails to pay defendant [general contractor], which includes sums due plaintiff [subcontractor], plaintiff agrees that it will not seek payment from defendant. Rather, defendant assigns all of its lien rights against the owner to plaintiff, and plaintiff shall accept this assignment in lieu of its legal remedies against defendant." Justice Benza held that this concept was barred by the reasoning in *West-Fair*.

One question left unanswered by *West-Fair* was how to treat the issue of retainage. General contractors commonly make their own obligation to pay retainage contingent upon the release of retainage by the owner. This makes sense, since retainage is intended to keep some amount of money "in the bank" to address any defects or deficiencies after the work is substantially complete. But at least one court has determined that some retainage language also violates the Lien Law's prohibition on advance lien waivers. The contract language at

issue in *Sawcutter Corp. v. DCI Danaco Contractors, Inc.*, 1 Misc.3d 906(A), 781 N.Y.S.2d 628 (N.Y.C. Civ. Ct. Dec. 31, 2003) provided:

> Final payment shall be due after completion of all work, acceptance by the Owner [the Dormitory Authority], compliance with all Sub-contract obligations and receipt of final payment for [sic] the Owner, which items shall be conditions precedent to the making of final payment to Subcontractor.

The court in *Sawcutter* determined that this language went too far and was barred by the reasoning in *West-Fair*. In all likelihood, the court reasoned that because the general contractor's obligation to release retainage was tied to receipt of final payment from the public owner, not just the particular subcontractor's satisfactory completion of its own work. Thus, the entire provision was deemed void. Perhaps this result could have been avoided if the language made clear that retainage would not be paid if the owner's refusal to make final payment was related to that particular subcontractor's work. For example, perhaps the following would have been more palatable:

> Final payment shall be due after completion of all work, acceptance by the Owner, compliance with all Sub-contract obligations and receipt of final payment from the Owner ***for the work of the Sub-contract***, which items shall be conditions precedent to the making of final payment to Subcontractor.

This language might have the effect of relieving the prime contractor of the obligation to pay the subcontractor, but only if the owner's non-payment is related to the subcontractor's own failure to perform work acceptable to the own E&D

By Theodore M. Baum

1 West-Fair Electric Contractors, Inc. v. Aetna Cas. & Surety Co., 87 N.Y.2d 148, 638 N.Y.S.2d 394 (1995)

2 What is "reasonable" may turn on the facts and circumstances of a particular case, but in general probably falls within a range of between 30 and 120 days.

3 Gomez Electrical Contractors, Inc. v. Bast Hatfield, Inc., Supreme Court, Albany Cty. Index No. 5136-01, decided December 8, 2004.

CONTINUED "COURT SOLIDIFIES"

for purposes of the Labor Law, the question was certified to the Court of Appeals.

After acknowledging the principle that a construction manager is generally not responsible for injuries under Labor Law §240(1), the Court's majority went on to recognize that liability may be imposed vicariously as an agent of the owner where the construction manager "had the ability to control the activity which brought about the injury." Citing earlier decisions, the Court framed the question of Turner's liability on a determination of whether it had "supervisory control and authority over the work being done when the plaintiff [was] injured."

For the majority in *Walls*, the answer was a resounding "yes". Turner, the majority believed, was not a "typical construction manager", having functioned as the "eyes, ears and voice of the owner", a role most construction managers would see themselves as serving. Specifically, the majority took note of four points in upholding the holding that Turner was a statutory agent of the owner for Labor Law §240 liability purposes:

- The contractual terms creating agency;
- The absence of a general contractor;
- Turner's duty to oversee the construction site and trade contractors
- The acknowledgement by Turner's representative that Turner had authority to stop unsafe work practices

In particular, the majority cited what it viewed as Turner's broad responsibility for coordination and overall supervision of the project, its contractual responsibility to monitor Jordan's work and protect Jordan's employees, and its duty to make sure workers on site were furnished with proper safety gear.

A three judge dissent did not believe Turner had authority to supervise and control the relevant work. "Where an owner retains for itself, and does not delegate to a general contractor, the power to choose contractors and supervise the job, it is the owner, not the owner's advisors—however well-heeded their advice might be—that should have Labor Law §240(1) liability". To the dissent, Turner was a typical construction manager, without the authority to supervise and control that a general contractor has. Decision-making authority remained with the owner, with Turner responsible to monitor performance and report deficiencies to the owner's architect. The dissent further questioned the relevance of contractual language relied upon by the majority that required Turner to direct trade contractors to stop work in the event of an unsafe practice or condition "which would constitute a hazard to school children or other users of facilities or properties in proximity to the work site." "[A] few benign safety-enhancing provisions in a contract should not be the basis for imposing Labor Law §240(1) liability on a company whose role was primarily advisory."

If the general rule remains that a construction manager/agent is typically not responsible for injuries under Labor Law §240(1), then the first lesson of *Walls* is that the rule may now be the exception. Construction manager/agents should no longer assume they will be spared Labor Law §240(1) liability. Second, construction manager/agents must decide if and how they will address oversight for project safety. Some construction managers will disclaim any and all responsibility; others will continue to see safety oversight as an important element of the services they provide, and will instead manage the risk through indemnification and insurance mechanisms. For those seeking to avoid liability altogether, they will need language in both the construction management agreement and in the owner's agreement with trade contractors. This language should clearly reiterate the trade contractor's responsibility for its own means and methods, as well as the responsibility for site safety. The other elements should include the obligation of the trade contractor to indemnify the construction manager for bodily injury claims and, more controversially these days, a requirement that the trade contractor name the construction manager/agent as an additional insured on its liability policy. Together, all these elements will better protect the construction manager/agent against Labor Law §240(1) claims, if no E&D elp to insulate the construction manager from such liability altogether.

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ERNSTROM & DRESTE NEWS

On September 12th and 13th of this year, Kevin Peartree presented a seminar on insurance considerations in Design-Build Contracts and Risk Management for the Design-Build Institute of America in Rochester, New York.

J. William Ernstrom presented a paper entitled *The Changing World of Contract Risk Management–Understand or Die!* at the 9th Annual Construction Financial Management Conference sponsored by AGC and CFMA in Las Vegas, Nevada on October 27, 2005. This was an interactive session dealing with the risk transfer methods currently being used by owners and a practical solution to the problems.

At the 25th IRMI Construction Risk Conference in Las Vegas, Nevada being held November 7-10, 2005, J. William Ernstrom will be a co-presenter for Construction Contract Negotiation. This session examines key risk allocation and insurance provisions, including indemnity provisions, insurance requirements and waivers of damages, with emphasis on the negotiation process.

The 2006 Supplement to the AGC Contract Documents Handbook will be co-authored by Kevin Peartree and Gavin Lankford and will be published this spring.

Theodore Baum is the co-editor of an upcoming American Bar Association publication, the Performance Bond Manual. Mr. Baum will also be one of the leaders of a panel discussion of that publication at the joint meeting of the ABA's Forum on the Construction Industry and the Fidelity and Surety Law Committee meeting to be held at the Waldorf-Astoria Hotel, New York, New York in January, 2006.

J. William Ernstrom and William Brueckner will be co-authoring a paper entitled Pre-Existing Adverse Conditions at the Project Site to be presented by Mr. Ernstrom at the 2006 ABA Forum Mid-Winter meeting to be held at the Waldorf-Astoria Hotel, New York, New York in January.

Todd Braggins is the co-editor of an upcoming American Bar Association publication, the Payment Bond Manual, Third Edition. Mr. Braggins will also be a co-chairperson of the FSLC Spring meeting to be held in Scottsdale, Arizona in April of 2006.