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Choice-of-Law Provisions Can Make Or Break Pay If Paid Terms

BY JOHN W. DRESTE

A New York trial level court has seemingly resurrected the enforceability of "pay-if-paid" provisions, depending on whether or not the underlying contract also has a non-New York choice-of-law provision. In *Hylan Electrical Contracting, Inc. v. Mastec North America, Inc.*, 2010 N.Y. Misc. LEXIS 3988 (Sup. Ct. Richmond Co., August 12, 2010), the court determined that a pay-if-paid subcontract clause was enforceable because the subcontract also contained a Florida choice-of-law provision and the court found that there were 'sufficient contacts' with Florida. In reaching its decision, the court relied upon *Welsbach Electric Corp. v. Mastec North America, Inc.*, 7 N.Y.3d 624 (2006), a decision from New York's highest court. In *Welsbach*, the court considered whether New York's policy on pay-if-paid provisions outweighed a contractually agreed upon choice-of-law provision which designated Florida as governing the parties' contract. The Court, noting that neither party was a New York corporation and

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Will Going Green Put Your "Green" At Risk?

An Uncertain Landscape for Contractors

BY NELL M. HURLEY

Pressure to "go green" seems to be everywhere, and the construction industry has experienced that pressure from almost every angle. While the espoused ideal appears admirable enough (who doesn't want to save the planet?), the complexity and uncertainty of this development has made it difficult for contractors to gauge the risks that this green landscape presents.

Of special significance to the construction industry is the emergence of "green building," where owners incorporate the benefits of sustainable design and construction such as energy efficiency and resource preservation. The advantages of building green can include financial incentives, perceived prestige or goodwill and perhaps, spiritual rewards. However, efforts to support those green goals, once voluntary, are appearing in legislation, regulations and codes which can have contractual and legal implications for contractors.

While there is no consensus as to what constitutes "green building," the functional concepts of sustainability, energy efficiency, reduction in the use of natural resources and negative impacts on the environment are commonly employed. In almost all cases, in order to receive the incentives or meet the mandates, **the building or renovation will require some third-party certification that it meets green standards**, often the U.S. Green Building Council's LEED Rating System. Such certification usually does not occur until after the project is complete.

Meeting the green standards, like the LEED certification or green building codes, presents a whole set of risks not previously encountered in the typical construction scenario. **Today, standard construction contracts do not adequately address the responsibilities and risks of green building.** Many of the "green" terms may not be defined, which can lead to ambiguity or uncertainty as to how a green goal is to be achieved. Even if the green terms are defined, the responsibilities among the various parties for their contributions to the green certification process are not identified. There can be long lead times and performance problems with green products as technology develops, and the availability and quality of those materials are often inconsistent or unproven. Good practices for such a green building have not yet been well integrated. If there is a green code or mandate in place, is compliance the responsibility of the contractor, as with other types of building codes? Most importantly, what happens if the project does not meet the third-party certification requirements? Are there specifications and warranty provisions that place the risk of the project's green performance on the contractor? What damages can the owner recover for such a failure, and from whom? As the complexity of the building and novelty of the materials and processes increase, so does the risk of catastrophic failure, such as mold.

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Fair Play Or No Play? NY's New Restrictions On Independent Contractors

BY MATTHEW D. BROWN

New York recently enacted the Fair Play Act, a drastic response to the perceived tendency of certain types of contractors to misclassify workers as independent contractors. The old standards for determining whether a worker is truly an independent contractor have been discarded for new standards which are incredibly broad and which shift the burden of proof onto the contractor to show that a worker is not an employee.

Under the Fair Play Act "any person performing services for a contractor will be classified as an employee unless the person is a **separate business entity**," as defined in the Act, or unless three prescribed criteria (the ABC test) are met, "in which case the individual shall be an independent contractor."

In order to avoid the presumption of employment via the ABC test, all three of the following must be met: (A) the individual is free from control and direction in performing the job, both under his or her contract and in fact; (B) the service must be one that is outside the contractor's usual course of business to perform; and (C) the individual is customarily engaged in an independently established trade, occupation, profession, or business that is similar to the service at issue.

To avoid the presumption via the **"separate business entity"** status, a contractor must demonstrate that it complies with each of the following twelve criteria: (1) performs services free from the direction or control over the manner and means of performing service, subject to the contractor's right to specify the desired result; (2) is not subject to "cancellation or destruction" upon termination of the relationship with the contractor; (3) makes a substantial capital investment in the business beyond ordinary tools, equipment or a personal vehicle; (4) owns the capital goods and reaps the profits or bears the entity's losses; (5) makes its services available to the public or the business community on a continuing basis; (6) includes the services rendered on a federal income tax schedule as an independent business or profession; (7) performs services under the entity's own name; (8) pays for its own license or permit if a license or permit is required; (9) furnishes the necessary tools and equipment; (10) hires, if necessary, its own employees, without the contractor's approval, pays its employees without reimbursement from the contractor, and reports its employees' income to the IRS; (11) is free to perform similar services for others on terms of its own choosing; and (12) does not represent to its customers that it is an employee of the contractor.

Posting Requirements

New job-site posting will be required. In additional to information concerning employees' rights to Workers' Compensation coverage, unemployment insurance, minimum wage, overtime, and other workplace protections, contractors will also need to post information about penalties for non-compliance, the rights of employees to be free from retaliation for exercising their rights under the Act, and contact information for filing a complaint. The new Poster is available through the New York State Department of Labor's web site.

Penalties

The Fair Play Act carries both civil and criminal penalties against business entities, as well as individuals who own ten percent or more of the company and who knowingly allow a willful violation of the law. First time offenders will be subject to fines up to $2,500. Repeat offenders will be subject to fines up to $5,000 for each violation within a five year period. Potential criminal penalties include imprisonment for up to 30 days or a fine up to $25,000 for the first offense, and imprisonment for up to 60 days or a fine up to $50,000 for a subsequent offense. Additional penalties may also be assessed, including debarment from public works projects.

Steps to Ensure Compliance

While the legislative intent of the Fair Play Act is certainly valid and just (to stop willful misclassification), questions remain about how the new law will be interpreted by the courts and whether the legislation will have unintended side effects, such as the destruction of legitimate independent contractor relationships. In the meantime, contractors in New York that engage with independent contractors should take action to ensure compliance with the law, including:

- Conducting an internal audit to determine how many individuals are retained as independent contractors.
- Reviewing business agreements, records, and actual practices relating to the "ABC" factors and/or the 12 "separate business entity" factors.
- Restructuring the parties' agreements and relationships in a bona fide manner, including actual practices in the field to ensure that current, legitimate IC relationships, that may be capable of withstanding restrictive tests of the new law, can be maintained and will not be stricken down and penalized.
- Reclassify workers and groups of workers previously classified as ICs, including those who would otherwise qualify as ICs under the common law test, if they cannot survive the "ABC" test or qualify as a "separate business entity" under the 12-factor test, even after a bona fide restructuring.
- Ensure that any re-classified workers as well as existing employees are reported to the Unemployment Insurance Division and covered by the contractor's Workers' Compensation policy, and that income taxes are withheld and payroll taxes are reported and paid to federal, state, and any applicable local government tax agency. E&D

Best Available Retrofit Technology ("BART") Update

BY THOMAS K. O'GARA

The Summer 2010 ContrACT Newsletter reported on the implementation of the 2006 Diesel Emissions Reduction Act which requires reductions in emissions of pollutants from heavy duty vehicles ("HDVs") owned by contractors, subcontractors and sub-subcontractors involved in public projects. Certain provisions of the regulation went into effect on November 1, 2010 and full retrofitting compliance was expected by the end of 2010. However, there have been two recent developments that have impacted the enforcement of this regulation by the New York State Department of Environmental Conservation (DEC).

On December 9, 2010, the DEC issued a letter stating that it will not enforce this regulation until after a decision is made by the Appellate Division, Third Department

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Some construction industry organizations have begun to address these issues in an effort to fairly allocate these risks. ConsensusDOCS has introduced one solution that addresses all parties to the construction project, the ConsensusDOCS 310 Green Building Addendum ("GBA"). The GBA creates the position of a Green Building Facilitator ("GBF") who advises the owner and undertakes responsibility for the green certification process. The GBF role can be assumed by the contractor, the architect, a construction manager or another third party, who then coordinates so that all parties meet the documentation requirements which lead to third-party certification. The GBA is a supplement to existing contract documents, but ensures that the roles of the parties relative to the "green building" requirements are specifically considered and determined before construction commences.

Until such risk allocation provisions are more widely applicable, contractors should approach "green building" construction with caution and careful contract review. Obviously, the more experienced and educated the contractor, designer and owner are about green construction, the more likely the project will be successful. All parties should be aware that the **use of standard construction industry form documents without modification to address the risks presented by green building is fraught with peril**. At minimum, the contract should clearly state the green objectives of the project, including which standard or third-party rating system will be used to achieve them. The contract documents should also specify which party is responsible for obtaining the green certification and for reporting and submitting the necessary documentation. Finally, the contract should delineate the contractor's role in providing such documentation and clarify the attendant time requirements.

Equally important is that the contractor carefully examines all specifications or warranty provisions that reference a particular performance standard and modify them accordingly, even adding language that expressly disclaims the contractor's representation that a particular green performance standard will be achieved. The contractor should only agree to perform in accordance with the owner-approved design, plans and specifications – warranting that *its work* will meet those standards, **not that the building will perform as *desired***.

Risks of delay are heightened on green building projects because of new design, technology, materials and processes, all of which may lead to unexpected change orders or field modifications, so provisions to insulate the contractor from liability for that risk may need to be added. In addition, the standard payment and warranty triggers such as substantial completion and final payment should not be tied to the green certification date, which will likely be many months after the contractor has completed its work. In a contract where consequential damages are waived, damages for failure to meet the green standards (e.g. loss of tax credits) should be specified as consequential damages, thereby protecting the contractor. Flow down clauses to subcontractors consistent with these modifications should also be employed. The guiding principle is that the contractor should limit its risks, as much as possible, to those it can control. E&D

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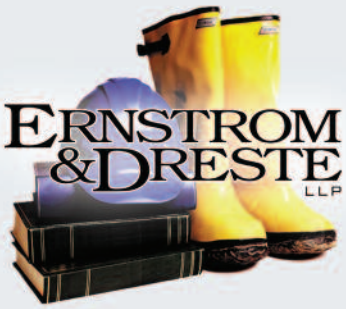
that both were sophisticated entities, upheld the pay-if-paid clause stating it was not so "truly obnoxious" as to void the choice-of-law provision.

While on the surface, *Welsbach* and *Hylan* appear to present bad news for subcontractors, the true message is that it depends at least on when the subcontract was entered. In both *Welsbach* and *Hylan*, the courts were interpreting pre-2003 contracts. Notably, in late 2002, New York enacted a new law which addresses prompt payment to contractors, subcontractors and suppliers on private jobs and also voids any term of a construction contract that mandates that the law of another state govern the agreement. (New York Gen. Bus. Law Art. 35-E). Thus, all private construction contracts performed in New York (except those with materialmen) are required to be governed by New York law, regardless of the state law designated in the contract. If the subcontracts in *Welsbach* and *Highland* had been entered after January 2003 (the effective date of the legislation), the law of New York would have been applied to the contract and the pay-if-paid provision would have been deemed void as against public policy.

If you are a contractor that works in multiple states, be aware that many states have similar statutes voiding contractual "choice-of-law" provisions, if the law sought to be applied is that of a state other than the state where the construction project is located. For example, a New York based general contractor who works on a project in Tennessee will not be able to litigate or arbitrate disputes with its subcontractors in New York or under New York law even if the subcontractor specifically agrees to such a contract provisions. Tennessee, like New York, requires disputes arising out of Tennessee construction projects to be resolved within the state of Tennessee and under Tennessee law; notwithstanding any contract agreement of the parties. The status of such legislation is worth checking into before you venture into foreign states. E&D



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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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in an appeal challenging the law brought by the New York Construction Materials Association. The appeal is scheduled to be heard January 12, 2011, though a decision may not be entered until spring. This will give the industry time to pursue other avenues for relief from the regulation including political and legislative solutions.

On December 14, 2010, the Supreme Court, Onondaga County issued a decision limiting the DEC's enforcement of this regulation. The court stated that DEC was not authorized to compel compliance of the regulation by subcontractors and suppliers. The court ordered the DEC to promulgate a new definition of "on behalf of" in order to exclude subcontractors and suppliers. However, the court did state that there was no reason to declare the regulation or the statute unenforceable, only the section of the regulation dealing with subcontractors and suppliers. The DEC is likely to appeal the decision.

Before the DEC stayed enforcement, all contractors should have electronically submitted a Regulated Entity Vehicle Inventory List (of all non-exempt vehicles weighing greater than 8,500 pounds and operating on diesel fuel) as well as an "Annual Report" to the DEC by November 1, 2010. Additional information about these forms is published online at http://www.dec.ny.gov/chemical/4754.html. Contractors should be ready to comply with the BART regulation in the event the Court sides with the DEC. While the fate of the BART regulation is uncertain, this temporary stay of enforcement is a big victory for the construction industry. E&D