ERNSTROM & DRESTE LLP

FIDELITY & SURETY REPORTER

FALL 2009 ISSUE 15

How Will Climate Change Legislation Change The Climate for Construction?

BY DOUGLAS A. BASS

As of the writing of this article, the "American Climate and Energy Security Act," also known as the "Waxman-Markey Bill" remains pending in the U.S. House of Representatives, with the Senate yet to offer any alternative. Whatever one's politics may be, it is likely that something will ultimately be passed, and the House version (the "Climate Bill" for short) is a probable template. The broad scope of the Climate Bill seeks as its end-goal to convert the United States into a "Green Economy," and has a major focus on the energy efficiency of all existing and newly constructed structures. The legislation will have economic and life-style repercussions throughout this country, and even seeks to reach world-wide. Existing structures in the U.S. account for (according to some sources) as much as 50% of the greenhouse gasses ("GHG") emitted in this country. It is impossible to realistically attempt to deal with GHG reduction without targeting new, and existing buildings.

This emerging further intrusion by the Federal Government into the construction industry will come on the heels of various state-level actions that raise concerns. In California, millions of dollars worth of public work has reportedly been "paid" by the state in the form of IOUs. In New York, there is a practical freeze on public work change order approval despite a continuing contractual mandate that the contractors proceed with the work, knowing that payment is likely going to trail performance. What happens when a subcontractor or supplier wants cash? Is the Owner in default, or has the Owner performed in accord with law? Does the contractor (or its surety) become the de facto financier for the project? How will this new far-reaching Climate Bill legislation impact or add to all of these current issues? And what new unforeseen issues will the Climate Bill create, especially in terms of performance obligations and the related responsibility for end results? In short, how will the far-reaching Climate Bill affect the climate for construction?

There are several major issues that this bill will force us all to consider:

1. What are the upfront costs to successfully make the transition to a new way of building and can they be offset to a significant degree if states and contractors "play ball" with the federal government?
2. Who bears the risk of the energy efficiency requirements necessary under the bill – the designers, the constructors, the owners or some combination of all? What will the impact be on smaller contractors specializing in private work if the bill forces the cost of doing business higher than a small business can absorb?
3. What opportunities does the bill create? An enormous amount of construction work should be generated not only to build the structures of tomorrow but to retrofit

CONTINUED ON PAGE 2

School District Claims Require Strict Compliance and Clarity

BY MONIQUE F. MAZZA

Two recent decisions by a New York appellate court underscore the importance of complying with the stringent notice of claim and statute of limitation requirements of the Education Law and the fatal consequences for sureties and contractors that do not comply. New York Education Law §3813 requires litigation to be commenced within one year after a cause of action arises. But before that, a written notice of claim must be served upon the school district's governing body within three months of the date on which the claim accrued. Failure to file the notice of claim can be fatal to the lawsuit.

When there is a construction claim, more often than not the cause of action is for the contract balance, and arises on the date payment for the amount claimed is denied. If a claim is expressly denied, the accrual date is easy to determine. The more difficult situation arises when a school district simply ignores the request or otherwise fails to remit payment without comment. When this happens, New York courts have held that a surety or contractor has notice of the rejection when they should have

CONTINUED ON PAGE 3

IN THIS ISSUE

CONTINUED "HOW WILL CLIMATE CHANGE LEGISLATION CHANGE THE CLIMATE FOR CONSTRUCTION?"

those of today. New "green" energy sources will need to be built, requiring the erection of acres of windmills and solar panels, for example. New cottage industries for specialists in the new national energy code, inspectors to ensure compliance, and vocational educators to train the next generation of contractor will spring up.

4. What will be the impact on the construction economy? Will the legislation create new jobs and opportunities or instead make it more difficult to meet project goals? Will this make the U.S. less competitive in the world market?

Among other things the legislation tackles is building energy efficiency by creating national percentage targets for energy use reductions in new residential and commercial buildings as measured against the baseline 2006 International Energy Conservation Code and the and the American Society of Heating, Refrigerating, and Air-Conditioning Engineers, Inc. (ASHRAE) Standard 90.1-2004:

- On the enactment of HR 2454, a 30% reduction in energy use relative to a comparable building constructed in compliance with the baseline code or standard;
- In 2014 for residential buildings and 2015 for commercial buildings, a 50% reduction in energy use relative to the baseline code or standard;
- In 2017 for residential buildings and 2018 for commercial buildings, and every three (3) years after through 2029 and 2030, respectively, a 5% additional reduction in energy use relative to the baseline code or standard.

The Energy Department will establish a National Energy Efficiency Building Code for residential and commercial buildings that meets these targets if the currently recognized developers of national energy codes and standards fail to do so. Once established, states and localities would be required to ensure their codes meet or exceed these targets. States that are non-compliant risk becoming ineligible to receive funding under the bill or allowance allocations.

Also provided for is the establishment of a building retrofit program for residential and non-residential buildings. The EPA and Energy Department will develop standards for national energy and environmental retrofitting policies to be administered through programs called the Retrofit for Energy and Environmental Performance (REEP) program. The purpose of the program is to facilitate the retrofitting of existing buildings across the United States to achieve maximum cost-effective energy efficiency improvements and significant improvements in water use and other environmental attributes.

Also of interest to contractors will be the EPA's establishment of greenhouse gas emission standards for new heavy-duty vehicles and engines and for non-road vehicles and engines and national goals for reductions in transportation-related greenhouse gas emissions. E&D

Tolling Agreement? What Tolling Agreement?

BY THOMAS K. O'GARA

A Connecticut trial court recently held that the statutory limitations period applicable to a Connecticut public works bond is a jurisdictional requirement that cannot be modified or extended by mutual agreement between the parties. The court dismissed the action, finding that the claimant's failure to adhere to the bond's statute of limitations deprived the court of subject matter jurisdiction to hear the case.

In *Paradigm Contract Management Co v. United States Fidelity & Guaranty Co.*, 2008 Conn. Super. LEXIS 874 (Conn. Super. Ct. 2008), Paradigm Contract Management Company ("Paradigm") was hired as a sub-subcontractor for a public works project for the City of Danbury. When Paradigm did not receive payment, it timely notified all necessary parties, and brought an action on the bond against the general contractor's surety, United Stated Fidelity & Guaranty Company ("USF&G"). The project closed in 1998 and Paradigm commenced the lawsuit sometime in 1999, within the one-year statute of limitations for public work bonds as set forth in Conn. Gen. Stat. § 49-42, Connecticut's Little Miller Act.

Originally scheduled for trial in April 2002, the parties instead agreed to an adjournment. Accordingly, Paradigm and USF&G entered into a written Tolling Agreement, effective April 19, 2002, in which both parties agreed to withdraw the case and waive statute of limitations defenses. Paradigm recommenced the action in March 2003, within the time prescribed by the Tolling Agreement, but almost five years after the completion of the project. USF&G then moved to dismiss the recommenced action because it was filed beyond the one-year limitations period contained within Connecticut's Little Miller Act. The judge denied this motion, ruling that one-year statute of limitations requirement could be waived.

The case was thereafter transferred to a new judge and scheduled for trial in March of 2008. Shortly before selecting the jury, Paradigm moved to dismiss USF&G's 2006 counterclaim for attorney's fees on timeliness grounds because it was asserted more than a year after the completion of the project. While arguing the motion to dismiss the counterclaim before the new judge, USF&G orally, and then by written motion, asserted that if Paradigm was permitted to raise the statute of limitations as a defense, then so too could USF&G. Accordingly, USF&G renewed its motion to dismiss Paradigm's entire claim as untimely.

Paradigm countered by arguing that the lawsuit was timely because it was suing on the bond as a common law obligation, and therefore subject to a longer statute of limitations, rather than as a Little Miller Act bond. Paradigm contended that execution of the tolling agreement transformed the action from a lawsuit pursuant to a public works bond to a lawsuit pursuant to a common law bond.

It is well-established in Connecticut that when a public works bond is issued, the Little Miller Act is read into the bond and the two are construed together.

viewed the school district's silence as a rejection. The following two cases provide a good example of the complexities of this issue.

In *Zurich American Insurance Company v. Ramapo Central School District*, 63 A.D.3d 729 (2d Dep't 2009), New York's appellate court for the Second Department refused to dismiss a claim against a school district because the school district failed to demonstrate that the surety's claim had been finally rejected, expressly or constructively. The surety's principal submitted claims to the school district on December 2005 seeking compensation for additional work performed on a project. In its claim letter, the principal did not set a deadline or other ultimatum for payment, but instead requested that its claims simply be accepted, or otherwise submitted to mediation. On February 7, 2006, the school district's architect declined to approve the claims and referred the principal to the mediation provisions of the contract. More than a year later, in February 2007, the matter was unsuccessfully mediated and the school district advised the principal that its claims were rejected. Within three months of that, the principal filed notice of claim and Zurich, as surety and assignee of its principal, filed its lawsuit in November 2007.

The school district immediately moved to have the lawsuit dismissed on the basis that the notice of claim was untimely under the Education Law since it was filed more than three months after the architect's February 7, 2006 letter. The school district also argued that the lawsuit was untimely because it was not brought within one year of the February 7, 2006 letter. The motion was denied because the February 7, 2006 letter from the architect did not "unequivocally deny" the principal's demand for payment and the conduct of the school district "was not so unambiguous" that the principal should have viewed the denial of its claims to be a final determination. To the contrary, the court determined that it was clear from the parties' correspondence and engagement in voluntary mediation that they were attempting to resolve their dispute. The court noted that if the school district's position was that the claim was barred by the principal's failure to serve a timely notice of claim, "it would have been disingenuous for the School District to have participated in voluntary mediation."

In another recently decided case from the Second Department, the court reached the opposite result. In *Fapco Landscaping, Inc. v. Valhalla Union Free School District*, 61 A.D.3d 922 (2d Dep't 2009), the appellate court agreed with the school district's argument that the complaint of contractor, Fapco Landscaping, Inc. ("Fapco"), was barred as being untimely under the Education Law. On July 28, 2004, Fapco made a demand for payment to the school district for the construction of two athletic fields. Notably, and in contrast to the claim letter in *Zurich*, the demand letter here set forth a date of August 4, 2004 as the deadline for the school district to pay. In response, the school district, by letter dated July 29, 2004, rejected Fapco's demand for payment. Subsequently, Fapco brought suit against the school district to recover damages for breach of contract on September 29, 2005. The court, however, dismissed Fapco's lawsuit as untimely because it was outside the one-year mark under the Education Law. Specifically, the court determined that the cause of action accrued at the earliest on July 29, 2004, when the school district expressly rejected Fapco's demand for payment, and at the latest on August 4, 2004, the deadline established in Fapco's demand letter. Thus, under either date, Fapco's lawsuit was brought more than one-year from the time of accrual. In addition, the court held that since the school district established that the one-year statute of limitations expired, the trial court was without power to grant Fapco leave to serve a late notice of claim.

These cases not only underscore the importance of complying with statutory notice requirements, they also illustrate the need to bring clarity to the contract claim process. When the record is unclear, the courts will assess all the circumstances and decide when a surety or contractor seeking payment should have viewed the claim as constructively rejected. The language employed by sureties or contractors in their demand letters for payment will be scrutinized by courts trying to determine when a claim actually accrued. For sureties and contractors interested in preserving their claim rights, the better course of action is to leave no doubt in the mind of the court or the school district. Assert claims and payment deadlines clearly and then calendar dates for further action. F&D

CONTINUED FROM FACING PAGE

Accordingly, the court found that the statute creates a floor of protection, below which the coverage of a bond cannot fall. Furthermore, the court reasoned that since a lawsuit seeking payment pursuant to a Little Miller Act bond is an invention of statute, the one-year statute of limitations constitutes a jurisdictional requirement. Consequently, commencing an action within one-year of completion is a condition precedent that must be established in order for the court to maintain subject matter jurisdiction over the action. Since this is a jurisdictional requirement, it cannot be waived or modified by the parties and can be raised at any point during the litigation.

The court recognized that its ruling directly contravened the express, written intent of the parties. While sympathetic to the plight of Paradigm, the court nevertheless was compelled to dismiss the action, stating: "matters of subject matter jurisdiction are not controlled by equitable considerations nor by agreements of the parties. This court has an obligation to dismiss the case when it concludes that it lacks subject matter jurisdiction." However, a silver lining did appear for Paradigm, as the court determined that since its case was dismissed, it was not responsible for USF&G's attorney's fees. Small consolation indeed. F&D

ERNSTROM & DRESTE LLP

NEW YORK
180 Canal View Boulevard
Suite 600
Rochester, New York 14623

Visit us online at:
WWW.ERNSTROMDRESTE.COM

ERNSTROM & DRESTE NEWS

Douglas A. Bass presented an overview of the Waxman-Markey Climate Act Bill at the National Bond Claims Association 2009 Annual Meeting in Atlanta, discussing risks and opportunities for the construction and surety industries created by the proposed legislation and the efforts to transform the United States into a "Green Economy".

Ernstrom & Dreste also publishes the ContrACT Construction Risk Management 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).