CONSTRUCTION RISK MANAGEMENT REPORTER

ERNSTROM & DRESTE LLP

ContrACT

FALL 2020 ISSUE 27

The Agony of Assignment and Risk of Delayed Pursuit

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As a part of a dispute settlement process, it is not uncommon for a contractor to take an assigned claim from a subcontractor in order to pursue a sub-sub or supplier where that party may bear responsibility for the cause of the settled claim. A recent decision from a New York federal district court reminds us that the assigned claim will be strictly limited to the rights of that subcontractor, including the applicable statute of limitations provision.[1]

The matter stems from façade renovation work performed on a building in Brooklyn, New York. In 2011, the owner of the building, CJUF III 20 Henry Property LLC (CJUF), contracted with B&A Restoration Consulting, Inc. (B&A) to construct a new building façade. B&A contracted with Edison Coatings, Inc. (Edison) to supply the stucco to be used on the project (Stucco Contract). The project was completed in 2013.

In 2016, a large chunk of stucco broke off one of the renovated facades and the building's Board of Managers complained of cracks in the façade causing water infiltration, severe spalling and detachment of the coating. The Board brought suit in state court against CJUF for breach of contract, among other claims, related to the defective stucco. B&A and the project engineer were impleaded into the state court action, but Edison was not.

The entire façade was eventually replaced. In 2018, CJUF, B&A and the engineer settled the state court case with the Board of Managers, with each party paying one-third of the settlement amount. B&A then assigned its rights under the Stucco Contract to CJUF.

CJUF commenced a federal court action against Edison in 2019 based upon diversity jurisdiction, since Edison is a Connecticut company. CJUF asserted three claims against Edison: breach of the Stucco Contract (the assigned claim), common law indemnification and contribution. Edison moved to dismiss the action, arguing that CJUF's claims fail as a matter of law. The court agreed and dismissed all three claims.

Although the Stucco Contract contained a Connecticut choice of law clause, the court looked to New York law for issues involving accrual and statutes of limitations, since New York is where the claim accrued. The applicable limitations period for the Stucco Contract was found to be four years under the New York Uniform Commercial Code, as the claim was founded upon the sale of goods. Next, the court determined that the claim accrued when the stucco was delivered, which necessarily occurred prior to the 2013 project completion date. The court rejected CJUF's argument that the latent nature of the defective stucco delayed the accrual since "in the absence of a warranty explicitly extending to future performance, a breach occurs when tender of delivery is made." Because more than four years had elapsed between delivery of the stucco and commencement of the action, the breach of contract claim was dismissed.

The court was unpersuaded by CJUF's efforts to circumvent this result by arguing that it had no direct right of action against Edison prior to B&A's 2018 assignment of the breach of contract claim. The court noted that CJUF asserts two (albeit unsuccessful) direct claims in the action (common law indemnification and contribution) that it also possessed at the time of the state court action in 2016. Regarding the breach of contract rights that exist only by CJUF's status as assignee of B&A, the court stated:

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Exclusions, Exceptions, and Confusion: A Recent Ruling on CGL Coverage

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An often litigated issue for contractors is the extent of coverage for liability under a contractor's commercial general liability (CGL) insurance policy. The common language of a CGL policy provides that it covers the insured's liability for "personal injury" or "property damage" caused by an "occurrence." An "occurrence" is typically defined as "an accident." CGL policies usually contain exclusions to coverage for "Breach of Contract" and "Your Work." In other words, the CGL policy is intended to insure against accidents; it is not a guaranty against breaches of contract or defective work.

The point of friction in CGL disputes, particularly for contractors, is whether liability on construction projects is caused by an accident, defective work, a breach of contract, or some combination thereof, as well as the nature of the property that was actually damaged. This issue was addressed in the recent case of *RD Rice Construction, Inc. v. RLI Insurance Co.*[1]

In *Rice*, a home remodeling contractor performed renovation work for the homeowners, which consisted of gutting and rebuilding two combined residential cooperative units. After the renovation work was complete, the

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> CJUF cannot escape the consequence of B&A's failure to implead [Edison] in the [state court action] by arguing it had not yet been assigned the rights it now possesses. The court need hardly explain why, as a matter of law and policy a valid affirmative defense against a claim cannot be extinguished by mere assignment.

In other words, the same limitations period that applies to B&A must necessarily apply to CJUF.

The court also rejected CJUF's actions for common law indemnification. CJUF sought indemnification from Edison based upon Edison's "sole culpable conduct" of supplying defective stucco, but failed to allege that Edison breached a legal duty independent of the Stucco Contract, said the court. The claims settled in the state court action relate entirely to the alleged wrongdoing of CJUF in breaching its own contracts and duties to the Board of Managers, not any negligent conduct by Edison. As such, reasoned the court, CJUF was not held vicariously liable for Edison's wrongdoing, but instead directly responsible for its own actions. The court stated:

> It is well-established that "in New York, a party cannot obtain common-law indemnification to recover damages resulting from its own breach of contract." (citations omitted).

Similarly, CJUF's claim for contribution failed because it did not demonstrate a legal duty separate from Edison's obligations under the Stucco Contract. Contribution may not be invoked to apportion liability arising solely from breach of contract, said the court. Framing Edison's provision of defective stucco as "culpable conduct" that caused property damage and life-safety issues is insufficient to create tort liability, it concluded.

Clients are sometimes frustrated with the way litigation can become a "sue everybody involved" affair, potentially increasing the costs and the time for resolution. But leaving potential defendants out of the room where it happens can have unintended consequences, as it did here. The decision does not address why B&A did not timely sue Edison, nor did it reference the actual date of the stucco delivery (accrual date). It is possible that B&A's claim, even if asserted in 2016, could have been untimely, if the stucco was delivered in 2012. Perhaps the parties failed to make the distinction between the general statute of limitations for contracts (typically six years from breach or, for construction, from completion) and those for the sale of good (four years from delivery), when the claim was assigned in 2018. In any event, this much is clear: The assignee gets the same rights the assignor has (or doesn't) at the time of the assignment, no more and no less. Be sure you know what you're getting. E&D

1 *CJUF III 20 Henry Property LLC v. Edison Coatings, Inc.*, 19-CV-1954 (NGG)(PK), 2020 U.S. Dist. LEXIS 137692 (E.D.N.Y. July 28, 2020).

What a Difference a Year Makes: MTA Debarment Regulations Update

Last fall's edition of this publication reported on a 2019 state law, its hastily created "emergency" regulations and an Executive Order issued by Governor Cuomo[1], all of which combined to create a mandatory five year debarment period for any Metropolitan Transportation Authority (MTA) contractor that violated the so-called "10% rules" (completing a contract 10 percent late or seeking payment of 10 percent more than the contract amount). The regulations expanded MTA's discretion to extend that debarment to related corporations and affiliates and the Executive Order required all other state agencies to honor MTA debarments, essentially ending public work for the debarred contractor. To top it off, the regulations applied retroactively.

Good governance groups, construction industry associations and even some MTA officials expressed concern over both the manner in which the process was handled and the likely effects upon contractors and MTA contracts. In January 2020, the Alliance for Fair and Equitable Contracting Today (AFFECT), a coalition comprised of five contractors' groups, sued the MTA on various constitutional grounds, including violation of contractors' due process rights.

Interestingly, by May 2020, the MTA Board authorized the process of replacing the emergency regulations with final regulations, including the issuance of guidelines to address the many concerns raised by contractors and other interested parties. After the required publication of the final (revised) regulations, on July 22, 2020, the MTA Board agreed to their adoption. The final regulations modify the original proposed regulations in the following ways, among others:

1. Narrows the scope of the regulations: eliminates retroactive application, applies only to *direct* MTA contracts over $25 million (no application to subcontractors), limits definition of an invalid claim by the contractor, to allow more claims;
2. Injects flexibility into the MTA's determination to bring debarment proceeding: eliminates mandatory debarment, permits MTA to defer pursuit of debarment where contractor has acted in good faith and good cause is shown for contractor's position, allows all contractor defenses to be asserted in debarment proceeding;
3. Composition of the panel for MTA debarment is changed to include a neutral from the American Arbitration Association and only two MTA employees, instead of three;
4. Contractor's related entities/individuals must receive written notice of the debarment proceeding and can only be debarred if:
    a. The contractor was created as a single or limited purpose entity specifically for the MTA contract; or
    b. The related entity/individual had a material and knowing causal connection to the contractor's debarment conduct.

From a contractor's perspective, these regulation changes should cause a collective sigh of relief, presenting a more equitable MTA debarment process. While they do not address the Governor's mandatory "if debarred by one, then debarred by all" obligation among state entities, at least the MTA's debarment process now reflects the basic safeguards provided by other agencies and federal contracting procedures. In this instance, at least, the danger of government over-reaching was recognized and rectified. E&D

1 N.Y. Pub. Auth. Law § 1279-h, 21 NYCRR 1004, et seq., Executive Order 192.

CONTINUED "EXCLUSIONS, EXCEPTIONS, AND CONFUSION: A RECENT RULING ON CGL COVERAGE"

homeowners complained of a draft situation, and Rice returned and installed additional insulation in the unit. Two months later, an HVAC unit pipe broke, causing a water loss which resulted in damages in the unit, including to the custom flooring installed by Rice. The homeowners' area rug was also damaged.

The homeowners carried a homeowners' insurance policy with AIG, who obtained a judgment against Rice for the damage to the floors and rug. After obtaining the judgment, AIG pursued collection against RLI, Rice's CGL carrier, under Insurance Law § 3420.

The CGL policy contained the typical coverage provisions and exclusions for "Breach of Contract" and "Your Work." However, the CGL policy also contained a "Subcontractor Exception" to the "Your Work" exclusion, which covered claims if the damaged work was performed by Rice's subcontractors.

In ruling that RLI owed no coverage under Rice's CGL policy, the court held that the pipe burst was not an "occurrence" because CGL policies do not "insure against faulty workmanship in the work product itself but rather faulty workmanship in the work product which creates a legal liability by causing…property damage to something other than the work product itself." The pipe burst was a result of Rice's faulty insulation work and, thus, was not an "accident" said the court. This accords with New York's law that a CGL policy should not be transformed into a surety bond.

The court further determined that the Breach of Contract exclusion precluded coverage since Rice's insulation work was warranty work under the original remodeling contract, not a separate contract for a separate scope of work. The court further held that the Subcontractor exception to the Your Work exclusion did not transform the pipe burst event into an "occurrence" based on New York precedent that CGL policies do not provide for coverage for breach of contract or warranty claims, even if the work is performed by subcontractors.

Central to the court's holding was the determination that the flooring that was damaged was installed as part of the remodeling project. Therefore, the court reasoned, it was damage to Rice's work product. The court noted that damage to the homeowners' area rug was covered by the CGL policy.

Upon close examination, this distinction appears to undercut the foundation of New York's jurisprudence on CGL policies: that CGL policies are not substitutes for surety bonds. A performance bond claim, for example, may cover damage to both the contractor's work product (the flooring in *Rice*) *and* other property at the project site (the area rug in *Rice*) depending on the consequential damages provisions in the bonded contract. Thus, the court's focus on the nature of the damaged property as the determinative factor for coverage does not align with the rationale that CGL policies are not substitutes for performance bonds.

A more sound approach is to analyze the nature of the injurious event. As noted by AIG in its briefing papers, other states, like New Jersey, are moving away from the rigid interpretation of CGL policies adopted by New York. The anomaly in the Rice court's holding justifies a refreshed approach by New York courts to CGL policy interpretation. E&D

1 2020 N.Y. Slip. Op. 31328 (U), Index No. 651185/2018 (Sup Ct., N.Y. County, May 7, 2020).

Recent E&D Appellate Result

A defaulted subcontractor cannot avoid judgment on liability with a bare-bones, self-serving affidavit, says a recent New York Appellate Division decision obtained by E&D. In *LeChase Construction Services, LLC vs. JM Business Associates Corp.*,[1] LeChase subcontracted with JM to provide rough carpentry in connection with a student housing project. During the project, LeChase sent JM numerous notices that JM's work failed to conform to the project specifications. JM left the job before completing its work. LeChase completed JM's subcontract work and brought suit against JM to recover its damages.

The Summons and Complaint were served through the New York Secretary of State. When JM did not respond, LeChase sought a default judgment on the issue of liability and a trial as to damages. JM opposed the default judgment, based solely upon the self-serving affidavit of JM's president that JM never received the Summons and Complaint. The trial court rejected JM's effort to avoid liability and its decision was upheld on appeal. The appellate court relied on well-settled law that requires a defaulted defendant to present specific and credible evidence to successfully challenge a sworn statement that service was properly delivered to the Secretary of State. In other words, mere allegations of non-receipt are insufficient to overcome the presumption of proper service. E&D

1 181 A.D.3d 1294 (4th Dept. 2020).

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Ernstrom & Dreste, LLP also publishes the Fidelity and Surety Reporter. If you would like to receive that publication as well, please contact Clara Onderdonk at conderdonk@ed-llp.com. Copies of ContrACT Construction Risk Management Reporter and The Fidelity and Surety Reporter can also be obtained at Ernstrom & Dreste, LLP's website (ernstromdreste.com).

FIRM NEWS

Kevin Peartree recently authored a chapter on the ConsensusDocs Design-Assist Addendum for the annual supplement to the ConsensusDocs Contract Documents Handbook, to be published in 2021 by Wolters Kluwer.

Kevin Peartree and Todd Braggins played in the July 30, 2020 Annual Golf Tournament jointly sponsored by The Builder's Exchange of Rochester, NY and the Rochester, New York Chapter of the Construction Specifications Institute. The event was held at The Links at Greystone & The Golf Club at Blue Heron Hills in Wayne County, NY. E&D was a cart sponsor.

Matthew Holmes is now a Staff Editor for the ABA - TIPS Fidelity & Surety Law Committee's quarterly newsletter, providing topic input and review of articles prior to publication.

E&D's longtime administrative professional Judy Martin retired from E&D this summer. E&D has added Jacqueline Lang to its team in that role. Ms. Lang earned her associate degree from Finger Lakes Community College in Canandaigua, NY and brings experience as a litigation assistant.