Peckar & Abramson

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newsletter

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Construction Community Responds to Terrorist Attacks

Within hours, hard hats volunteered to go into the rubble to find survivors, leaving their work on construction projects in other parts of the New York and Washington, D.C. metropolitan areas. Joining the rescue workers and medical personnel were ironworkers, steamfitters, crane operators, carpenters, welders and laborers, all bringing their special areas of expertise to assist in the rescue effort. Other construction jobs were shut down so that personnel and heavy equipment could be moved into the affected areas. By the next day, structural engineers arrived at the World Trade Center to inspect the integrity of surrounding structures, and to determine how to remove the 1.2 million tons of debris, including 300,000 tons of structural steel, without causing additional damage or jeopardizing the safety of workers. Engineers from the Port Authority of New York and New Jersey and their consultants began working on a plan to prevent further havoc and destruction in the tunnels underneath the complex which cross the Hudson River and serve the PATH, the commuter rail line from points in New Jersey.

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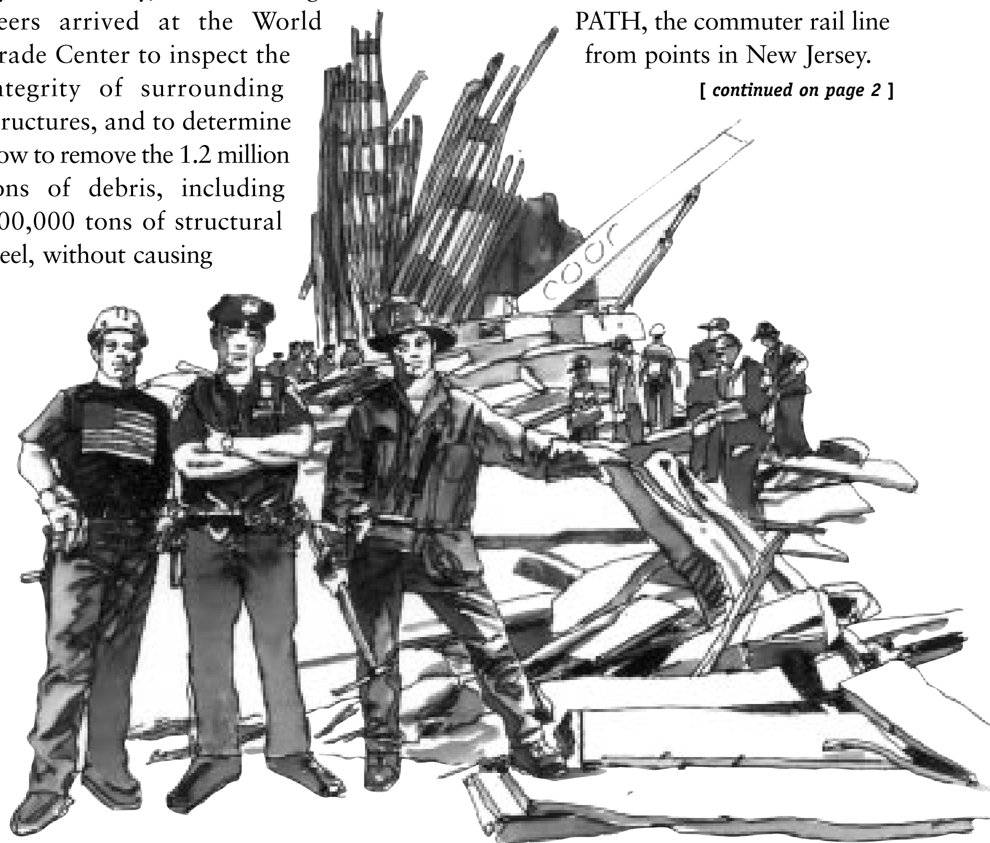

ILLUSTRATION: LIAM ROBERTS

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By the end of the week, the New York City Department of Design and Construction ("DDC"), acting under the Office of Emergency Management, had retained four teams of construction managers to oversee the removal effort, dividing the area where the World Trade Center complex once stood into four quadrants. Each quadrant was assigned to one of the construction managers. Among the construction managers are Peckar & Abramson clients, Turner Construction Company and Amec Construction Management, Inc., in addition to Bovis Lend Lease and Tully. (Amec is also involved at the Pentagon, having recently completed renovations on Wedge I, near the point of attack on the southwest side. Wedge I has held up.) The DDC also retained six teams of structural engineers, two from LZA Technology, a division of The Thornton-Thomasetti Group, to work double 12-hour shifts to oversee the removal effort.

Construction trade associations have also been in the forefront in responding to the tragedies. Both union and contractor associations in New York and New Jersey, as well as the national associations to which they belong in Washington, D.C., have come forward with assistance. Not only have these organizations expedited the process of making workers and equipment available, but they have also purchased and donated hard hats, gloves, eye protection and breathing masks. According to Jack Kocsis, Executive Director of the Building Contractors Association of New Jersey, communications are ongoing with both the New York and New Jersey building trades, which are extremely involved in the process. Plans for future activities include establishment of education funds for the children of craft and management employees of construction firms who were lost in the tragedies, as well as for the families of fire, police, emergency workers and construction men and women who gave their lives attempting to rescue victims of the attacks.

By the next day, structural engineers arrived at the sites to inspect the integrity of surrounding structures.

Long-range questions and issues abound. Among them are: How will the lost 12 million square feet of prime New York City office space be replaced; what effort should be put into accelerating existing projects; and will the existing shortage of skilled workers become more acute as a result of the diversion of workers to clear the sites? However, according to Louis Coletti, Chairman of the New York Building Trades Employers Association, his organization is already working with private developers to address these issues and expedite the replacement of office space in New York City. Plans are also being developed for rebuilding in downtown Manhattan.

On the other hand, sponsors from both the public and private sectors are seriously reconsidering the timing of and financing for cultural and stadium projects that have long been in the planning stage and had been ready to move forward. Many of these projects may have to be postponed or even scrapped. New arenas for New York area teams like the Yankees, Mets, Devils and Nets, and the long-awaited renovations to Lincoln Center may be threatened. Final decisions on going forward may not be made for weeks or months, but the availability of funding and personnel to keep these projects on schedule will have to be reassessed.

A more immediate problem is the transportation of material and equipment to and from construction sites in New York City. The unprecedented vehicular traffic delays into the city have resulted in the reinvention of traditional construction methods. For example, portable concrete batching sites are being built in Manhattan to service local projects since the time to transport concrete from outside the city exceeds its cure time. With regard to the removal effort, Weeks Marine, a New Jersey-based company, is using floating cranes on the East and Hudson Rivers to load the rubble and steel from the fallen towers from trucks onto barges, to be floated to a landfill in Staten Island.

A more complex, long-range issue is how structures will be designed, built and maintained in the future. Questions regarding not only the integrity and strengthening of buildings, but also how to deal with egress, utilities and communications when a building is attacked, must be reexamined.

In any event, the effect of the attacks on the construction industry will be monumental in the years ahead. It appears almost certain that there is a need to augment the construction workforce in both the short and long runs, given the need to rebuild the areas that have been destroyed, and to strengthen and retrofit those buildings that may be likely targets in the future. ❁

Surety Bonds:

Has Our Day Come?

Over the 23 years that I have operated exclusively within the contract surety industry, the dynamics of the market have never existed as they do today. There has been a dramatic increase, industrywide, in surety carrier direct loss results. At the very same time, we find ourselves, in New Jersey, for example, at the forefront of the largest public works program ever undertaken by the state. Large-scale public works programs and, in particular, school construction programs are being launched in a number of other regions as well. A recipe for disaster? Not for the reputable, quality contractor.

Over the past eight to ten years, quality, legitimate contractors that pay prevailing wage rates, 100 percent of subcontracts and 100 percent of material purchase orders have found it increasingly difficult to compete in the public sector. In fact, a number of contractors have made a business decision to either withdraw entirely from the public sector or not enter at all. A significant factor driving the inability of the quality contractor to compete was the freewheeling and seemingly limitless capacity of surety credit available to clearly unqualified, marginal contractors. The raging investment climate and profitable surety industry results drove the availability of tremendous excess surety credit capacity. Sureties allowed underwriting standards to be severely compromised. Virtually unabated surety program limits, waiver of basic surety guarantees, expanded geographic range and the undertaking of unfamiliar project types in all too many cases went unchecked. Financial viability and financial position of the sureties' principal contractors seem to have little, if any, correlation to the surety program being extended. As one seasoned surety underwriter put it, "Underwriting has been reduced to the ability of the contractor to fog a mirror and pay for the bond." Not quite, but perhaps not far off.

Readily available surety credit for the unqualified, marginal contractor is rapidly, if not entirely, over.

Today, the investment climate, a significant source of income for insurance and surety carriers, has substantially turned. Surety losses generally take from two to three years to manifest from when an account is originally acquired and bonds are issued. Accounts acquired during the height of the soft market, 1996 through 1999, are the accounts sureties now find in claim. Given the roaring economy at the time, coupled with virtually unlimited surety capacity, those same contractors are in the sureties claims departments frequently with unprecedented high backlogs of uncompleted work.

Readily available surety credit for the unqualified, marginal contractor is rapidly, if not entirely, over. Quality contractors will now be in a position to compete on a more level field against other contractors of like kind and quality. It becomes a lesson in Economics 101–basic supply and demand. On the supply side, available surety credit is constricting, coupled with an ongoing shakeout of marginal construction firms. On the demand side, the amount of public work available to bid will increase significantly. Quality contractors will be in a position to competitively acquire projects previously thought unattainable and at reasonable margins.

While it has been widely anticipated that surety industry direct loss results would deteriorate, the magnitude of deterioration is dramatic. Based on the Surety Association of America's 2000 "fast track" results, contract surety losses

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(performance and payment bond losses) have doubled over 1999's level and tripled over 1998's level. A direct loss ratio over 40 percent is considered unprofitable. With the surety industry's contract surety direct loss ratio averaging 52.5 percent, contract surety as a line of business within the surety industry was unprofitable. Individual carrier direct loss ratios of major national sureties range to 108 percent. The surety industry's expense ratio is generally considered to be in the range of 60 percent. As such, the combined ratios range to 168 percent. That is to say, for every $1.00 of direct premium earned, $1.68 was paid out in direct losses and expense. Of the top 15 national sureties, two are under state control/liquidation. For the year 2000, as an industry, the surety carriers incurred direct losses in excess of $1.5 billion.

Primary surety carriers reinsure, or "lay off," a portion of any potential loss. As a result, reinsurance carriers are incurring dramatic loses as well. This has driven up the cost of reinsurance to the primary carriers. In addition to primary carriers facing higher reinsurance costs, in some cases reduced availability of reinsurance is also an issue. As such, some of those same primary surety carriers are accepting higher exposure levels, i.e., retaining higher levels of risk on new bonds being underwritten. Higher risk retention levels of the primary surety carriers will drive constriction in the availability of surety credit, reestablishment of underwriting requirements and, perhaps, even higher surety bond rates.

Is the turmoil within the surety industry cause for concern? Hardly. The surety industry will survive. On the one hand, it shows that surety bonds are a needed vehicle to protect the owners' construction dollars, be they public or private. On the other hand, for quality contractors operating financially viable companies, performing within their means and satisfying their obligations, your ability to compete in the public sector will be restored, in part by the surety industry regaining its underwriting sanity. Quality contractors will continue to have made available adequate levels of surety credit by quality surety underwriters. It's been a long time coming, but finally our day has come.

Private Developer + Public Owner of Real Estate = No Lien Claim

Jersey Electrical Supply Co., Inc. v. MJR Electrical Contracting Corp.

As part of its efforts to clean up and develop the Times Square area, the City of New York, in conjunction with the 42nd Street Development Project, Inc. ("Development"), a public benefit corporation, leased property to Dream Team Associates, LLC ("Dream"), which, in turn, subleased it to Loews Festival, Inc. and Loews 42nd Street Cinemas, Inc. (collectively "Loews"), for the development of a movie theater. Loews hired Tishman Interior Corp. as its general contractor, which in turn, hired MJR Electrical Contracting Corp. ("MJR") as its electrical subcontractor. MJR hired Jersey Electrical Supply Co. ("Jersey") to furnish certain materials for the project.

This action was initiated as a result of MJR's failure to pay Jersey almost $200,000 for materials. Then, Jersey filed a private improvement lien under the New York Lien Law, which Loews bonded off. Jersey then moved to foreclose on the bond.

Although the parties agreed that MJR owed the funds to Jersey, the court ruled that Jersey had no lien rights to enforce. The problem was that the private improvement Lien Law does not permit liens on publicly owned property, even when that property is leased for private development. The court cited a long list of New York cases, which barred a mechanic's lien from being asserted on the leasehold interest of the tenant of publicly owned land. Although a 1992 amendment to the Lien Law allowed liens to be filed on public property being privately developed when legal title is vested in an industrial development agency, this amendment was of no assistance to Jersey. Although Development was a subsidiary of New York's Urban Development Corporation and had the same function as an industrial development agency, Development was a public benefit corporation and, therefore, not covered by the amendment.

The court felt constrained to enforce the Lien Law as written, and felt it was barred from relying on equitable principles to expand the Lien Law's remedial powers. The court ruled that "[t]his conundrum seems patently unjust; however, until the legislature acts to correct the situation, this court is constrained to hold that plaintiff has no remedy under the Lien Law." Similarly, since the bond had been posted as a substitute for the lien, Jersey could not recover under the bond either, and Jersey's lien claim and bond claims were both dismissed. The court lamented the fact that the terms of the Lien Law allowed private parties "to unilaterally shirk their contractual duty to compensate plaintiff for services and materials provided in good faith simply because the property is publicly owned, especially when neither the city nor the public corporation had anything to do with the arrangement."

EDITOR'S NOTE:

Public/private partnerships for development of properties, especially in urban areas, have become increasingly common. Therefore, it is incumbent upon contractors to fully understand and appreciate their lien rights in order to ensure collection of all funds owed. Rights to recover under public and/or private liens, as well as bond claims, should be fully explored at the outset of the project. In many states, the lien laws and public bond acts require notices before work is performed in order to preserve the right to bring claims later. The old saw – "An ounce of prevention is worth a pound of cure"– couldn't be more applicable.

No-Damage-for-Delay Contract Provisions:

Proving the Exceptions

A.R. Mack Construction Co., Inc. v. Central Square Central School District/ Abax, Incorporated v. New York City Housing Authority

Contractors are frequently faced with the notorious no-damage-for-delay provision in their contracts, which exculpates parties from damages resulting from delays in performance. These clauses are generally valid, although most courts across the country agree that they cannot bar damages for: (1) delays caused by the protected party's bad faith or its willful, malicious or grossly negligent conduct; (2) uncontemplated delays; (3) delays so unreasonable that they constitute an intentional abandonment of the contract by the contractee; and (4) delays resulting from the contractee's breach of a fundamental obligation of the contract.

In New York, the standard was originally set forth in the 1986 New York Court of Appeals case of *Corinno Civetta Constr. Corp. v. City of New York*, which is still followed today. The key in these cases is for the contractor to convince the court that the delay in question falls within one of the court-approved exceptions. Recently, two contractors obtained opposite results from two different New York appellate courts, illustrating that the proper presentation of the facts is critical to recovery.

...all delays that a contractor is not responsible for may be a basis for the recovery of damages.

In *A.R. Mack Construction Co., Inc. v. Central Square Central School District*, a masonry contractor on a construction project for the school district attempted to recover damages when it was required to complete its performance of the contract under "materially changed conditions" allegedly caused by the school district and its agents. The appellate court explained that the record contained no evidence of willful misconduct or grossly negligent actions by the school district and, therefore, upheld the lower court's dismissal of the contractor's claim for delay. In the second case, *Abax, Incorporated v. New York City Housing Authority*, the contractor fared better. Although the lower court ruled that the no-damage-for-delay provision should be enforced, the appellate court modified the decision, and allowed the contractor to replead its action and attempt to recover delay damages against the contract manager.

In the latter case, Abax had entered into a contract with the contract manager for demolition and lead paint and asbestos removal work, as part of the modernization of a New York City housing project. The appellate court pointed to Abax's evidence demonstrating that there were more than 600 days of delay, including a substantial period during which the contract manager suspended the work. The court ruled that the almost two-year delay, which included a period of work suspension, may be indicative of delays "beyond the contemplation of the contracting parties or of an abandonment by the contractee" and, therefore, stated a meritorious cause of action for delay damages, notwithstanding the no-damage-for-delay provision.

EDITOR'S NOTE:

In truth, delays are rarely "contemplated" on construction projects. Therefore, all delays that a contractor is not responsible for may be a basis for the recovery of damages. The key is to persuade the court of the other party's unreasonable conduct. In *Abax,* it was apparently the lengthy suspension of the work that convinced the court that a fundamental premise of the contract may have been breached. Of course, Abax would still have to persuade the court at trial of the validity of the delay claim, at which time the contract manager would have the opportunity to present evidence that the delay and suspension were reasonable under the circumstances. On the other hand, in the *A.R. Mack* case, simply arguing "changed conditions" was not sufficient to induce the court to discount the contractual bar to delay damages.

"If It Ain't Broke, Don't Sue!"

California's High Court Sides with Builders in Construction Defect Suits

Aas et al. v. Superior Court (William Lyon Co.)

In a long-awaited decision that promises to have broad-sweeping implications for the residential construction industry in California, the state's high court ruled late last year that, in the absence of a direct contractual relationship, homeowners cannot sue builders and their subcontractors for economic losses in construction defect cases unless there exists actual property damage or personal injury.

The split decision by the court spells doom for the large number of construction claims now working their way through the courts, in which the plaintiffs have alleged construction defects but are unable to prove any actual property damage or personal injury. The ruling also promises to reduce the number of new cases filed in the state involving multifamily residential construction.

The case arose from the consolidation of two suits filed by more than 160 homeowners in two residential subdivisions in San Diego County. The developer, William Lyon, built both. Plaintiff in the first case, *Provencal Community Association v. William Lyon Company et al.* ("*Provencal*"), was the homeowners' association responsible for managing and maintaining the Provencal condominium project. Plaintiffs in *Aas et al. v. William Lyon Co.* ("*Aas*") were owners of single-family homes in subdivision known as Belle Fleur. Defendants included William Lyon Company and Lyon Communities, Inc., which served as developer and general contractor in both Provencal and Belle Fleur, and the many subcontractors who participated in those projects.

In each case, the plaintiffs alleged that their dwellings suffered from a variety of construction defects affecting virtually all components and aspects of construction. As a result, plaintiffs asserted causes of action for negligence, strict liability, breach of implied warranty and, in the *Aas* case alone, breach of contract and express warranty. The homeowners in both cases sought, among other things, the cost of repairing the alleged defects. Additionally, plaintiffs in *Aas* expressly sought damages representing the decreased value of their residences.

During pretrial proceedings, the defendants successfully excluded evidence of plaintiffs' alleged construction defects that had not caused any property damage. (There were no claims of personal injury.) Plaintiffs argued that while it was true that there was no property damage, the defects alleged constituted serious violations of the building codes that were intended to prevent harm to life, health and property. Examples ranged from improperly constructed shear walls that would not withstand seismic events, to garbage disposals that would not work. The appellate court denied plaintiffs' appeal of the trial court's exclusion of evidence.

The California Supreme Court affirmed the decision and expressly held that, absent any evidence of actual property damage or personal injury, a plaintiff could not maintain a claim for construction defects.

In reaching its decision, the Supreme Court reviewed more than four decades of construction defect cases to support its holding that the doctrine of strict liability does not afford a remedy for defects that have not yet caused property damage or personal injury. The court painstakingly discussed the difference between tort (negligence) recovery for physical injuries versus warranty recovery for economic loss. In drawing this distinction, the court relied upon the seminal 1965 case of *Seely v. White Motor Co.*, where the court held that in actions for negligence, a manufacturer's liability is limited to damages for physical injuries; no recovery is allowed for economic loss alone. This general principle, the so-called "economic loss rule," has prevented plaintiffs from recovering economic losses in pure negligence actions. Up until now, however, construction defect cases were considered hybrid tort-contract cases and thus were the exceptions to the so-called "economic loss rule." The court's definitive ruling is now a major obstacle to any lawsuit brought by a homeowner against a contractor or subcontractor, unless the homeowner has a direct contractual relationship with the party being sued.

...a construction defect claim cannot be maintained unless there is a contractual relationship between parties.

The decision did not come without controversy. Two dissenting justices were extremely critical of the ruling on public

policy grounds. One of the dissenters, Chief Justice Ronald George, rhetorically asked why a homeowner should have to wait for a personal tragedy to occur in order to recover damages to repair known serious building code safety defects caused by negligent construction. He noted that other states, like Maryland, when faced with the same question, have found for the homeowners. Chief Justice George found that the decision "offends both established common law and basic common sense." Justice Stanley Mosk, who believed that the decision would exacerbate the perceived threat that the construction industry would "cut corners," shared his sentiment. Both Justices felt that a more appropriate rule should be one that could distinguish the difference between a non serious latent defect (e.g., defective garbage disposal) and a more serious, life-threatening latent defect (e.g., electrical or structural defects).

The decision, undoubtedly pro-construction, should not be interpreted as a pardon or reprieve for poorly constructed dwellings in California. California's strict liability law continues to provide a great deal of protection to homeowners. For example, homeowners still have 10 years to sue for property damage, and there are no statutes of limitation for personal injury claims caused by a construction defect. In addition, the ruling has no impact upon contract and warranty law. ⚙

EDITOR'S NOTE:

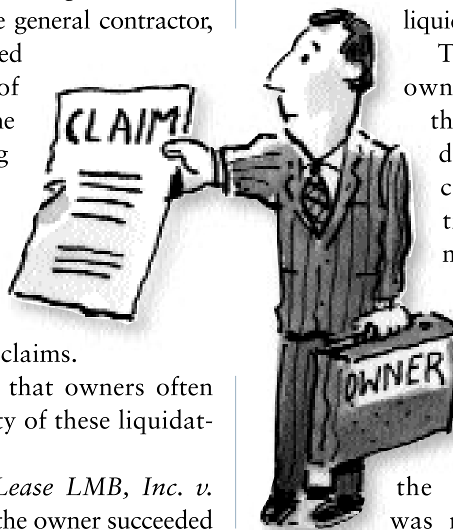
The decision is already having an immediate impact on cases being litigated in California. Our California offices are currently contemplating a number of summary judgment motions for lawsuits where residential builders have been sued by homeowners. The long-term outlook is less clear, and we would not be surprised to find an effort by the state's powerful trial attorneys' lobby to convince the legislature to enact a law bypassing this new holding. Now, the rule is clear: If a claimed defect has not caused property damage or personal injury, a construction defect claim cannot be maintained unless there is a contractual relationship between the homeowner and the responsible party. ⚙

Liquidation Agreements

Ruled Valid Under New York Law

Bovis Land Lease LMB, Inc. v. GCT Venture, Inc.

For decades, contractors have utilized liquidation agreements as a means to allow general contractors to assert claims against owners on behalf of their subcontractors. These agreements are extremely helpful for consolidating claims, thereby limiting the proliferation of lawsuits and inconsistent results. In the agreements, the general contractor agrees to be liable to the subcontractor for its increased costs, but only to the extent the general contractor is successful in recovering those costs from the owner. The general contractor, of course, is obligated to pursue recovery of those costs from the owner, with varying arrangements for the subcontractor's participation in, and financial responsibility for, prosecuting the claims. It is not surprising that owners often challenge the legality of these liquidating agreements.



In *Bovis Land Lease LMB, Inc. v. GCT Venture, Inc.*, the owner succeeded in persuading a New York trial court to dismiss a general contractor's claim for its subcontractors' delay damages on the basis that the liquidating agreement was invalid. The contract dispute stemmed from the restoration of Grand Central Terminal in New York City. An appellate court recently reversed the lower court's decision, thereby restoring the common practice in the industry of relying upon liquidating agreements.

The basis of the owner's challenge was that there was a no-damage-for-delay clause in the subcontracts. The owner maintained that the general contractor's admission of liability for the owner's delays in the liquidation agreement, was a nullity since the general contractor was not liable for delay damages by virtue of the no-damage-for-delay clause in the subcontracts. The owner argued that the liquidation agreement was a device to rewrite the subcontracts to create liability where none existed, solely to allow the subcontractors to assert delay claims against the owner. In addition, the

It is not surprising that owners often challenge the legality of those liquidating agreements.

ILLUSTRATION: LIAM ROBERTS

owner maintained that the general contract required that subcontracts be subject to the owner's prior approval, and, since the owner never approved the liquidation agreement, the agreement was unenforceable.

The appellate court acknowledged that liquidating agreements were commonly used in the industry. Implicitly, the court reasoned that despite the no-damage-for-delay clause, there was no reason why the general contractor could not modify the subcontracts to assume liability for delays. In addition, the court ruled that the owner's right to approve subcontracts applied only to preapproval of the subcontractors selected to perform the work, and that the clause gave the owner no generic right to preapprove subcontract terms and conditions, much less a specific right to pre-approve any liquidation agreement. ⚙

The basis of the owner's challenge was that there was a no-damage-for-delay clause in the subcontracts.

EDITOR'S NOTE:

Although not stated explicitly, but critical to the decision, was the court's reluctance to effect a radical change in the way that general contractors and subcontractors do business. Another consideration may have been the court's hesitation to leave subcontractors completely without a remedy. If a general contractor is not liable to subcontractors for delay damages caused by an owner and, therefore, cannot liquidate that liability, subcontractors would be left without any remedy when they incur cost overruns caused by an owner. The court effectively refused to create such a harsh, inequitable rule of law.

Of more concern is the owner's argument that it had approval rights over the subcontracts, and, because it did not approve the liquidating agreement that amended the subcontracts, the agreement was void. The appellate court was able to circumvent this issue by finding that the owner's approval rights were limited to approval of the selection of the subcontractors, and did not extend to the terms and conditions of the subcontracts themselves.

But, what if a contract does give an owner the right to approve or veto the terms of a subcontract? Obviously, an owner would resist both the inclusion of a liquidating agreement in the text of the subcontract itself or entering into a liquidation agreement after the fact. Would a court, in that situation, uphold the owner's right to control the terms of subcontracts and, thereby, exculpate itself from liability? Or would a court refuse to overturn the long-established practice of entering into liquidation agreements and rule that an owner cannot use an approval authority to insulate itself from liability? Clearly, the final chapter on this important issue has not been written. ⚙

In Memoriam and Tribute

We mourn the loss of lives in New York, Washington and Pennsylvania.

We are in awe of the bravery of the firemen, police, medical teams and ordinary citizens who risked and lost their lives to save others.

We support our president, the government and the armed forces that are leading the battle against the terrorists who committed the unspeakable attacks on September 11.

We applaud our clients and others in the construction industry who have been in the middle of the rescue and cleanup efforts, and who have had to face the horror of this unprecedented tragedy.

We pray for our country.

ILLUSTRATION: LIAM ROBERTS

Subcontractor Performance Bonds:

Is the General Contractor *Really* Protected?

General contractors are often faced with the question whether or not they should require subcontractors to provide performance bonds. These bonds serve as guarantees that subcontractors' work will be performed and completed in accordance with the requirements of the subcontractors. They also are intended to ensure that if a defect in a subcontractor's work is discovered after completion of the project, the resources of a surety will be available to answer for the problem if the subcontractor is unable or unwilling to do so. Performance bonds, however, add a significant cost to the project, and, therefore, contractors must weigh the risk of subcontractor nonperformance and defective work against this increased cost. Further complicating the decision is the fact that in some states, significantly Florida, the courts have ruled that the performance bond surety's obligation to fix latent defects is *not* a co-extensive with the subcontractor's.

Florida's statute of limitations for construction defects is four years from the completion of the work. Generally, this means that an owner asserting a defective work claim against a general contractor must file suit against the contractor within four years of the issuance of the certificate of occupancy. However, in the case of latent defects – those that are not readily observable – a lawsuit can be filed within four years of the date that the defects are discovered or reasonably should have been discovered. These same rules apply to a contractor's claims against a subcontractor and, logically, should also apply to claims against the subcontractor's surety. Unfortunately, according to the Florida Supreme Court, they do not.

In *Federal Insurance Company and McMerit Construction v. The Southwest Florida Retirement Center Inc.,* the Florida Supreme Court ruled that the statute of limitations applicable to claims made under performance bonds is five years, and is not extended by the discovery of latent defects after completion of the contract. To summarize the court's ruling:

• The statute of limitations applicable to a claim on a performance bond is five years from completion and acceptance of the project by the owner.

• The limitations period is *not* extended by the later discovery of latent defects.

• Therefore, any claim under a performance bond must be filed within five years of completion of the contract.

This ruling limits a surety's liability to a period of time shorter than the subcontractor's liability under its contract, and, in turn, limits the surety's liability to a period of time shorter than the general contractor's liability for the subcontractor's defective work. In extreme cases, the difference could be as much as 10 years. Consider the following example:

A contractor completes construction on January 1, 1998. The subcontractors, including the roofer, have provided performance bonds to cover work completed. Six years later, in 2004, the roof of the project fails as a result of the roofer's use of nonconforming materials. The use of nonconforming materials is determined to be a latent defect.

The owner has four years from discovery of the latent defect to file a lawsuit against the contractor, and the contractor has four years to file a suit against the roofer. Consequently, the time for filing suit would expire in 2008. However, the statute of limitations runs out in 2003 on any claim against the surety under the roofer's performance bond. This is one year before the latent defect is even discovered. If the roofer is out of business or for some other reason cannot satisfy the liability, the contractor is stuck, and the liability ends in his wallet.

Under existing bonds, five years after a subcontractor's work is completed, its surety is no longer subject to claims.

Under existing bonds, five years after a subcontractor's work is completed, its surety is no longer subject to claims. Therefore, contractors can protect themselves only through inspection and by rapid action when latent defect issues arise. However, it is important to remember that the five-year limitation applies to actually bringing a suit against the surety, not simply providing notice of a claim. With respect to new bonds, a solution is to add conditions to the bond to make the time limits for the surety's liability co-extensive with the subcontractor's. It remains to be seen whether bonding companies will agree to these terms. ❁

Our View:

Prompt Payment Legislation Is Not Really Necessary

Prompt payment legislation and laws seem to be all over the map these days. Last year, Arizona passed a comprehensive bill providing that owners on construction projects be required to make progress payments to contractors within seven days of the certification and approval of the billing. Failure to make the requisite payment subjects the owner to an interest penalty of 1.5 percent per month. Similarly, contractors are required to make payments to subcontractors within the same seven-day period and are subject to the same interest penalty for late payment.

Significantly, the Arizona law applies only to private – and not public – construction contracts. The legislation also specifically allows the parties to fashion their own contractual obligations for payment, as long as the payment terms are set forth in the contract in a clear and conspicuous manner, and provide for payment within a defined specified number of days. The paying party, whether it be the owner or the general contractor, can withhold payment for a host of reasons, including unsatisfactory job progress, defective construction work, disputed work, failure to comply with material provisions of the contract, third party claims that have been or may be filed, failure to make timely payments for labor or reasonable evidence that the contract cannot be completed for the unpaid balance of the contract sum.

If the foregoing exceptions to prompt payment obligations sound familiar, they should, because most commercial contracts already contain such provisions.

Following and emulating the Arizona law, the New York State Senate and Assembly last June passed their own prompt payment bill, which is awaiting signature by Governor George E. Pataki. However, the New York General Building Contractors ("GBC") is vehemently opposing enactment of the law. According to the GBC, the carpenters' union and New York City wall and ceiling subcontractors are behind this bill, based on their belief that prompt payment will result in better benefit fund payments. Like the Arizona bill, the New York bill only applies to private work. The GBC charges that many legislators who supported the bill were unaware of the bill's inapplicability to public construction contracts. The GBC's argument is that there are other ways to improve payments to the benefit funds without disrupting the entire payment process for private work with unnecessary regulations.

Our view is that the GBC is right. It is one thing for government to legislate how its tax dollars are handled by its contractors. It is another matter altogether for government to intervene and control private contractual matters. Indeed, this constitutes legislative interference in private affairs. What other industry receives legislative instructions on when to pay its bills on private contracts?

The answer is that the construction industry has been wrongly singled out for legislative interference. Payment provisions in private construction contracts should be set forth in the contracts between the parties, not in legislation. In fact, the exceptions to prompt payment obligations that are contained in both the Arizona law and the proposed New York law are almost identical to the exceptions that are contained in standard

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forms of contract general conditions pertaining to progress payments, including the AIA and AGC documents.

Moreover, legislation defining obligations for prompt payment for work performed, with the usual exceptions thereto, do not necessarily provide any advantage to the contractor and may prove in some instances to be disadvantageous. In order to invoke and enforce a prompt payment obligation, a contractor must prove that it is, in fact, entitled to payment and that the exceptions in the law are inapplicable. This is identical to a contractor's burden of proof in a lawsuit to collect money owed, even in the absence of a prompt payment law. The disadvantage is that it limits parties' rights to define contract terms as they see fit and appropriate in given situations.

Although New Jersey does not have a comprehensive, all-encompassing bill addressing prompt payment, that state does have a number of prompt payment provisions that apply to some aspects of the construction process. On state government public works contracts, it is required that general contractors pay their subcontractors for the work performed and approved by the state within 10 calendar days of the general contractor's receipt of payment. The law also requires general contractors to certify to the state that the subcontractor has been paid for the previous progress payment, and, if payment is withheld, the general contractor must give the subcontractor notice specifying the reasons therefor. Penalties for unexcused late payment include interest at prime plus 1 percent on the unpaid amount and court costs.

Another New Jersey statute that applies to both public and private contracts requires general contractors and subcontractors to pay their subcontractors within 10 days of receipt of payment from an owner or general contractor, except in situations where the parties have agreed in writing otherwise. If payment due is not made, the delinquent party is liable for interest on the money owed at prime plus 1 percent.

Although these laws were enacted to protect subcontractors, in actuality, they are infrequently invoked. In fact, there are no reported court decisions dealing with the enforcement of a prompt payment provision. The reasons are not entirely clear, but it is likely that payment issues are resolved through contract provisions, negotiation and resolution of claims, rather than under prompt payment laws.

What *is* clear is that the area that is most in need of legislative intervention – prime contracts with public entities – has not been addressed in any of the recently proposed legislation. These contracts are almost universally awarded through a public procurement process under which the bidding contractors have absolutely no say in the terms and conditions of the contract. As a result, public entities often load up the contracts with protective provisions that limit the contractor's ability to effectuate change orders for drastically increased and altered work scopes. For example, failure to adhere to strict notice and claim substantiation provisions will bar claims. Also, disputes clauses often incorporate statutes for processing claims that prohibit the recovery of interest, foreclose alternate dispute resolution techniques and prevent recovery of delay damages.

Legislation is needed to address these onerous contract provisions, which make it difficult or even impossible for contractors to profitably perform public work, and ultimately drive up costs to the public with higher bid prices and claims. To be sure, progress has been made in some areas, with some public procurement entities adopting mandatory alternative dispute resolution for claims, allowing interest and even attorneys' fees on successful claims and barring no-damage-for-delay provisions in all public contracts. These are significant legislative victories, but contractors need to work with their business associations and lobbyists for more meaningful reform.

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In sum, prompt payment legislation is not the answer. In private contracts, a contractor's ability to negotiate contract terms should not be impaired by overriding legislation that does not specifically address the needs of a particular project. With respect to public contracts, prompt payment provisions will not necessarily speed up the payment processes of recalcitrant public agencies. The real need is to address – through legislation, the regulatory process and judicial action – the harsh contract terms that public agencies incorporate in their contracts prior to bid. ⚙

Did You Know...?

According to the Division of Wage and Hour Compliance of the New Jersey Department of Labor, during the calendar year 1/1/00-12/31/00, the agency issued 6,734 prevailing wage determinations to public bodies awarding construction contracts. The agency's investigators completed 746 cases and cited 555 employers for alleged violation of the Prevailing Wage Act.

A total number of 40 construction firms were added to the debarred list, along with the names of 60 responsible individuals of those firms.

The agency actually collected $1,525,364 in unpaid prevailing wages from employers, as well as $630,453 in administrative penalties and $223,407 in administrative fees.

Michael P. McCarthy, Assistant Director, Division of Wage and Hour Compliance, provided this information.

Peckar & Abramson on the Hill

Peckar & Abramson is pleased to announce the opening of its Los Angeles office.

Raymond Buddie will be the Managing Partner of the Los Angeles office. He is the former mayor of Sausalito and a member of the Marin County Planning Commission. Mitchel I. Cohen, a senior associate with the firm, will reside in this office. His areas of practice are construction law and commercial and construction defect litigation.

The new Los Angeles office is located at:

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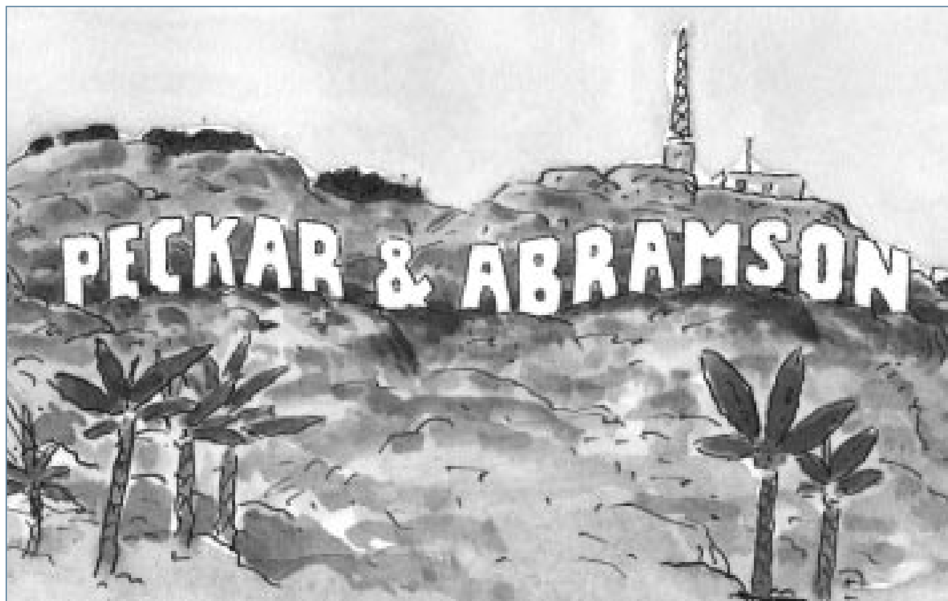

New Jersey Enacts Rules For Design Build Contracts

In August of this year, the New Jersey State Board of Architects enacted regulations pertaining to the provision of architectural services under a design build contract. Previously, state law had been virtually silent on this issue. The new regulations pertain to all construction contracts, public and private, between a contractor and an owner or developer, for the construction or alteration of buildings and structures within the state. The rules mandate that the contractor should enter into a separate written design contract with the architect, and preclude the architect from providing professional services unless the construction contract contains a prescribed NOTICE provision setting forth the architect's name, address and telephone number, and advising the owner of the following:

- The architect is an independent contractor, and is not an employee of the contractor.
- The architect is required to exercise independent professional judgment.
- The architect is permitted to discuss design issues with the owner.
- The owner is to be notified if the architect's services are terminated, suspended or discontinued.
- The architect must independently inform the owner of design changes.

These provisions are also required to be incorporated in the architect's contract. The regulations are contained in the New Jersey Administrative Code, NJAC 13:27-7A.

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