



Subcontractor Disputes

What You Need to Know

Presented by:

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STATISTICS

Data from 2017 suggests that disputes with subcontractors failing to understand their contracts are the third highest cause of construction disputes.

RED FLAGS



1. Failure to properly staff the project
2. Premature demands for money
3. Lien claims from suppliers or vendors
4. Writs of attachment being served
5. Delinquent tax notices or Levies
6. Notices from the DOL

RED FLAGS



7. Joint check agreements
8. Baseless change orders or requests for additional compensation
9. Bankruptcy – special considerations
 - a) Type of bankruptcy – 7 or 11
 - b) Dealing with trustee
 - c) Material in bankruptcy estate
 - d) Termination for bankruptcy – no

FORUMS FOR RESOLUTION

- Court of law (Litigation)
- Arbitration
- Mediation
 - Condition precedent to Court or Arbitration
- This must be clearly established in the contract

COURT OF LAW

- Judge or jury trial
- Length of time before resolution
- Costs of discovery, i.e. interrogatories, depositions, paper exchange, electronically stored information
- Award of post judgment interest (New York – high)
- Right of appeal
- Commercial part?
- Recommendation – no jury!

ARBITRATION

- Experienced arbitrator or panel of arbitrators with construction experience
- Quicker resolution
- Expense? Arbitrator costs? Filing fee costs?
- Very limited discovery, likely no depositions, likely just paper and electronic information exchange
- Very limited right of appeal
- COVID considerations

Recommendation: Arbitration over a court of law. Preference a retired superior court or federal judge or construction attorney.

MEDIATION

- Can be court ordered
- Agreed to contractually
- Totally non-binding
- Opportunity to evaluate your case
- Decide to cut losses and make business decisions
- Before proceeding to mediation, recognize that you are going to make some level of compromise
- Take it seriously!

ESTABLISH THE TEAM AND TASKS

- Key project personnel
- One point of contact
- Assessing and organizing documents
- Retaining experts
- Assessing potential costs

FACTORS TO ASSESS

1. Manpower drain – one person or many (current or former employees)
2. Cost vs. Recovery
3. Merits of the case - the valuation of evidence, i.e. paper, witnesses, and the story
4. Ability to recover

FACTORS TO ASSESS

5. Bonding company involvement/vouching in
6. Subcontractor Default Insurance
7. Airing dirty laundry
 - a) Creating of record that could come back to haunt you with the owner
 - b) Simultaneous suits with owner and sub (try to avoid at all costs)
8. Liquidating the subcontractor claim(s)
9. Warranty issues
10. Do you need the subcontractor? If you sue them, forget it!

UNIQUE SITUATION

Holding material hostage – special situation likely to occur during the Project

- a) Payment
- b) Court of law
- c) Clear ownership
- d) Harm to the project (public vs. private)

THE PERFECT WITNESS AND EVIDENCE

- Professional
- Rely on your contract
- Recite key facts and dates
- Few adjectives
- Kill them with kindness
- Perception is reality
- Write an email as if you're writing a formal letter

ANTICIPATING THE QUESTIONS

- What transpired?
- When did it occur?
- How did you respond?
- Please explain.

LAW AND ORDER SYNDROME VS. REALITY

- Anticipate at least 2 weeks of hearings
- Document intensive trials & hearings, ups and downs
- Bad testimony and documents
 - Anticipate as many pitfalls as possible
 - Bring out first and explain, don't hide

CONSTRUCTION DEFECT CLAIMS

Commercial construction projects often present unique challenges to the courts, in part because when an argument erupts over a claimed construction defect, it is inevitably complicated by the **conflicting interests of the parties**. The project owner wants the building to be free of defects, while other parties to the project, including the general contractor, its subcontractors and suppliers, the construction manager, if any, the architect and other design professionals, each may dispute the existence of, the extent of, and the responsibility for, any claimed defects. **Moreover, each of them may seek to shift the blame for any concealed defect to others and each will likely assert that it has the right to investigate the claim and to attempt to cure any defects that are identified.** Robertet Flavors, Inc. v. Tri-Form Construction, Inc., 203 N.J. 252, 256 (2010).

GOAL OF PROVING A CONSTRUCTION DEFECT CASE

- Shift risk of loss to subcontractors
- Demand indemnity
- Identify alleged defective conditions and related proof (i.e. documents, drawings, specifications)
- Demand cure, if not, do you repair?
- Pictures/video, with dates on pictures
- Testing/preservation protocol

SPOILATION OF EVIDENCE

Simple Definition in Layman's Terms

Do not rip out the defective work

CONSEQUENCES - Bad

Sanctions include limiting claims against a contractor as to conditions that were observable prior to dispute and possible dismissal of claims

WHAT MUST BE DONE

- Must give an opportunity to observe defective work
- Opportunity to review, record and inspect with expert
- May have to give sample

WHAT MUST BE DONE

- Number of Notices
 - At least one, three would be best – Review your contract and follow what it says!
- Emergency Situation
 - Videotape and record (pictures) condition, confirm the emergency in writing
- Recommendation
 - Do not rip out defective work until ample notice is given

PROVING DAMAGES FOR DEFECTIVE WORK

- Document time that is directly related to repairing the defective work
 - Separate work crew
 - Daily reports – task specific. Prepared on a contemporaneous basis
 - Description on how costs are kept (i.e. track in field, coded entries, timely loaded into project software/model)
 - Follow through with back charges as provided for in contract
 - Do not sit on back charges until the end of the project

DISPUTED EXTRA WORK

- Change Orders
 - The Golden Rule: Liability to sub should always be limited to compensation received from the owner
- Resist temptation to sign time and material tickets for work that is not extra
- Express clear reservation of rights in letters

GOALS OF PASS THROUGH/FLOW DOWN PROVISION

- Avoid simultaneous suits with one or more subcontractors and the owner
- Avoid inconsistent positions vis-à-vis owner and subcontractor
- Preserve/maximize the value of the prime contractor's claims against the owner
- Preserve/maximize the value of subcontractor claims that can be asserted against the owner
- Minimize/eliminate subcontractor claims against the prime contractor that cannot be asserted against the owner
- Defer resolution of any dispute with the subcontractors until owner/prime contractor dispute is resolved
- Preserve prime contractor claims against the subcontractor
- Avoid subjecting the prime contractor to inconsistent results and conflicting liabilities

LEGAL CONSIDERATIONS

- In the absence of a written agreement, State and Federal cases are inconsistent in determining whether the subcontractor's suit will be stayed pending resolution of the dispute between the owner and the prime contractor

LEGAL CONSIDERATIONS

- State and Federal case law generally enforce a written agreement to stay the subcontractor's suit pending resolution of the dispute between the owner and the prime contractor

LEGAL CONSIDERATIONS

- A general “incorporation by reference” provision is insufficient to protect the prime contractor against inconsistent obligations
- Important prime contract provisions should be explicitly incorporated – especially in New York
- The Written agreement to defer subcontractor litigation should not be characterized as a “pay-when-paid” clause

WRITING THE AGREEMENT: ESSENTIAL ELEMENTS OF THE PASS THROUGH PROVISIONS

- The contractor will pursue the subcontractor's reasonable pass-through claims against the owner
- The subcontractor will assist in the contractor's action against the owner
- The subcontractor will be bound by any determination that is binding upon the contractor
- The subcontractor will not commence suit or arbitration against the contractor until any dispute with the owner is resolved except as necessary to preserve the subcontractor's right to security, such as a mechanic's lien
- Any suit or arbitration the subcontractor is permitted to commence will be stayed pending resolution of the dispute with the owner
- Proceeds of any proceeding against the owner will be distributed between the contractor and the subcontractor



ACTIONS TO BE TAKEN WHEN SUBCONTRACTOR FILES FOR BANKRUPTCY

OBTAIN CRITICAL INFORMATION

- Determine the work to be completed under subcontract
- Determine the work in progress
- Obtain balances owed on subcontract
- Verify necessary information with third parties as required such as suppliers and materialmen
- Verify Mechanics Lien Right deadlines

TRACK BANKRUPTCY DOCKET AND IMPORTANT DATES

- File Appearance and Request for Notices
- Confirm Claims Bar Date
- Confirm Contract Rejection or Assumption Dates
- Confirm Plan Proposal Deadline

ASSEMBLE INFORMATION FOR MOTION FOR RELIEF FROM STAY

- Notice of Default Date
- Date Default Notice and/or Notice of Termination Given
- Subcontract Balance Due
- Amounts Paid to Subs
- Value of Material in Debtor's Custody

UNDERSTAND TIME CONSTRAINTS AND ROLE OF RESPECTIVE ATTORNEYS

- Understand Role of Debtor's Counsel
- Understand Role of Committee Counsel
- Understand Role of Debtor-in-Possession
- Importance of obtaining Stay Relief Prior to Plan Confirmation

KEEP END GAME IN MIND

- End Game to Preserve Rights and Claims
- Stay Relief Critical First Step
- Proof of Claim Filing Second Critical Step
- Establish Claims/Rights Quickly
- Avoid Protracted Litigation

QUESTIONS?

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