NYSBA SPRING 2003 | VOL. 29 | NO. 1

Construction & Surety Law Newsletter

A publication of the Torts, Insurance and Compensation Law Section
of the New York State Bar Association

Bulletin

Prompt Payment on Construction Contracts

Chapter 127 of the Laws of 2002 added Article 35-E to the New York General Business Law, effective January 14, 2003.

This statute imposes deadlines for the approval or disapproval of invoices and establishes due dates for interim and final payments on construction contracts, subcontracts at any tier and material supply contracts. It affords remedies for delay in the approval or disapproval of invoices and for untimely payment.

The statute applies to construction projects having an aggregate cost for labor, services, materials and equipment equal to or exceeding $250,000. It does not apply to public works projects; one-, two- or three-family residential dwellings; residential tract development of less than 150 one- or two-family dwellings; residential construction projects of less than 9,000 square feet aggregate; and median income government-assisted residential projects of less than 150 units.

Significantly, unless otherwise provided in Article 35-E, the terms and conditions of a construction contract supersede the statute and "govern the conduct of the parties thereto."

Billing Cycle

If the construction contract neglects to establish a billing cycle by mutual agreement, the statute inserts the calendar month in which work is performed as the billing cycle. A contractor or subcontractor may deliver an invoice for interim payment at the end of a billing cycle and an invoice for final payment upon completion of all work required under the contract or subcontract. All contractually required documentation and waivers must be delivered with the invoice.

Invoice Approval/Disapproval

The owner, contractor or subcontractor receiving the invoice must approve or disapprove all or a portion of it within 12 business days. An owner declining to approve an invoice must issue a written statement to the contractor describing the items not approved for one or more of the six causes listed in the statute. A contractor or subcontractor disapproving an invoice may withhold it from the application for payment submitted to the owner or contractor, for one or more of the five causes listed in the statute. Contractor or subcontractor approval may not be unreasonably withheld nor withheld in bad faith.

Payment

Payment for work performed and materials supplied during the billing cycle is to be made strictly in accordance with the terms of the construction contract. Unless otherwise agreed upon by the parties, payment of an interim or final invoice is due from the owner not later than 30 days after approval of the invoice.

An owner may withhold from an interim payment an amount reasonably expected to cure any defect or to correct any item specified in the written statement of invoice disapproval. Alternatively, an owner may withhold the line item amount identified in an agreed upon schedule of values as modified by change orders, additions or deletions *and/or* an amount sufficient to recover

liquidated damages as established in an agreed upon schedule in the construction contract. Such alternative withholdings must relate to one or more of the withholding justifications specified in the written statement of invoice disapproval.

The statute expressly states that performance by a subcontractor in accordance with the provisions of its contract entitles the subcontractor to payment from the party with which it contracts.

When a subcontractor has performed, its contractor or superior subcontractor must pay the full or proportionate amount of funds received from the owner for that subcontractor's work and materials within seven days after receipt of good funds for each interim or final payment. The paying contractor or subcontractor may withhold amounts similar to the withholdings authorized for owners (i.e., amounts reasonably payable as direct expenses to correct deficiencies; alternatively, schedule of values line items and/or liquidated damages associated with the deficiency). If a basis for withholding is discovered by the contractor after an invoice is submitted to the owner but before payment is made to the subcontractor or material supplier, the contractor must, as soon as practical and prior to the payment due date, issue a written notice of withholding to the subcontractor or material supplier and to the owner, then reduce the interim payment by the amount specified in the notice, and pay the withheld amount within seven days after correction of the identified performance deficiency and receipt of the owner's payment of the withheld funds.

Disclosure of Payment Dates

A contractor or subcontractor must accurately disclose to its subcontractors the due dates for receipt of payments from the owner or contractor. This disclosure must be made (in writing?) at the time the subcontract is executed. If disclosure is not accurately made, the subcontractor must be paid as though the owner complied with the payment due dates prescribed by the statute. Furthermore, a subcontractor may issue a written request to the owner obligating the owner to provide notice to the subcontractor within five days after making any interim or final payment to the contractor. The request is effective for the duration of the subcontractor's work on the project.

Remedies

Delay of any payment beyond the due date incurs interest on the unpaid balance at the rate of one percent (1%) per month or fraction of a month, unless the construction contract imposes a higher rate of interest.

A contractor or subcontractor may suspend performance if the owner fails to approve or disapprove an invoice, or if the owner or contractor fails to make timely payments of undisputed invoice amounts. Suspension of performance must be preceded by written notice to the owner and contractor of not less than ten calendar days and by an opportunity to cure within that time period. A subcontractor shall not be deemed to be in breach of the construction contract for suspending performance in accordance with the statute.

Retainage

The statute authorizes owners and contractors to negotiate a reasonable amount of the contract sum as retainage. Retainage held by a contractor or subcontractor may not exceed the actual percentage retained by the owner. Retainage must be released not later than 30 days after final approval of the work under a construction contract. The failure to release retainage when due incurs interest at the rate of one percent (1%) per month from the due date.

Loan Proceeds

Payment due dates are extended by seven days after the receipt of loan proceeds necessary to make the payment if (a) the owner, contractor or subcontractor, as the case may be, has obtained a loan to pay all or part of a construction contract; (b) a timely request for disbursement of loan proceeds has been made; and (c) the lender is legally obligated to disburse the proceeds but has failed to do so in a timely manner.

Prohibited Terms

Under the statute, a construction contract (except a contract with a material supplier) may not be made subject to the laws of another state, nor may it require any litigation, arbitration or other dispute resolution proceeding to be conducted in another state. Furthermore, the right to suspend performance for failure to receive prompt payments cannot be waived in a construction contract. Any such provisions are made expressly void and unenforceable.

Some Issues

What constitutes "final approval of the work under a construction contract" to trigger an obligation to release retainage? How does a subcontractor whose work is completed prior to the overall completion of the project avoid delay in the release of its retainage if the prime contract does not provide for release on a subcontract-by-subcontract basis?

In its 1995 *West-Fair*[1] decision, the New York Court of Appeals held that a "pay-when-paid" provision of a

subcontract violated public policy to the extent it shifted the risk of owner default from the prime contractor to the subcontractor and impaired the subcontractor's rights under the New York Lien Law. Has *West-Fair* been intentionally or inadvertently overruled by this statute?

Epilogue

It will be necessary for the parties to construction contracts to coordinate the terms of prime contracts, subcontracts and material supply contracts, and to preview statutory disclosure requirements in order to avoid the application of New York's "prompt payment" act when such application is unanticipated or unintended.

Endnote

1. *West-Fair Electric Contractors v. Aetna Casualty & Surety Co.*, 87 N.Y.2d 148, 638 N.Y.S.2d 394 (1995).

Summary of Decisions and Statutes

ARBITRATION

29-1. A trial court has no discretion to compel arbitration on equitable principles where the party demanding arbitration failed to fulfill an express condition precedent in an American Institute of Architects Standard Form of Agreement. After prospective homeowners terminated a demolition and excavation contract with the contractor, the contractor demanded arbitration pursuant to the agreement. Reversing the trial court's decision compelling arbitration, the Second Department held that since the contractor failed to submit its claim to an architect in a timely fashion as required by the standard form, it was barred as a matter of law from seeking arbitration. *Anagnostopoulos v. Union Turnpike Management Corp.*, 300 A.D.2d 393, 751 N.Y.S.2d 762 (2d Dep't 2002).

ARCHITECTS, ENGINEERS AND SURVEYORS

29-2. In an action for copyright infringement, the land surveyor's site plans, which set forth existing physical characteristics of the site (such as grade contours, shape and dimensions of the site, and the location of existing elements) were not copyrightable since they merely affirmed existing facts. However, the surveyor's detailed specifications of proposed physical improvements of the site (such as preparation of the building footprints, creation of parking lots and placement of utilities) constituted a fully realized plan capable of being used to guide actual construction work and were thus copyrightable as specific expressions and realizations of sufficiently concrete and detailed ideas. *Sparaco v. Lawler, Matusky, Skelly, Engineers LLP*, 303 F.3d 460 (2d Cir. 2002).

INSURANCE

29-3. A general contractor was potentially liable under Labor Law § 240 for injuries to a subcontractor's employee upon whom a piece of equipment fell while being loaded with a hoist onto the subcontractor's truck. The general contractor was an "insured" under the subcontractor's "business auto coverage" policy, entitled to defense and indemnification by the subcontractor's business auto insurance carrier. "Use" of a vehicle includes loading and unloading within the meaning of the Vehicle and Traffic Law. *Paul M. Maintenance, Inc. v. Transcontinental Insurance Company*, 300 A.D.2d 209, 755 N.Y.S.2d 3 (1st Dep't 2002).

29-4. A subcontractor's employee who was injured in a fall from a job site stairway sued the municipal owner, the general contractor and other subcontractors. The general contractor was an additional insured on the liability policy of the employer subcontractor. The insurer disclaimed coverage asserting that any liability of the general contractor was based on negligent supervision of subcontractors other than the employer subcontractor whose work was unrelated to the stairway. The insurer therefore argued that coverage was excluded by the terms of the policy. Additionally, the policy excluded obligations to pay damages for bodily injury where liability was assumed in a contract or agreement, except that the exclusion did not apply to liability imposed on an additional insured outside of such a contract or agreement. The First Department noted that the complaint stated a cognizable claim for liability against the general contractor on a basis other than its contract with the municipal owner, namely strict liability under Labor Law § 241(6) (plaintiff allegedly tripped over exposed wire mesh constituting a tripping hazard within the meaning of the Industrial Code (12 N.Y.C.R.R. § 23-1.7(e))). The Court concluded that the insurer failed to meet its heavy burden to demonstrate that the allegations of the complaint fell wholly within the (supervision) exclusion, that the exclusion was subject to no other reasonable interpretation, and that there was no possible factual or legal basis upon which the insurer might eventually be obligated to indemnify the additional insured under any policy provision. Furthermore, the contractual liability exclusion failed to unambiguously exclude liability imposed vicariously by operation of law. Accordingly, the general contractor was entitled to coverage as an additional insured. *Morse Diesel International v. Olympic Plumbing & Heating Corp.*, 299 A.D.2d 276, 750 N.Y.S.2d 72 (1st Dep't 2002).

LABOR LAW §§ 200, 240, 241

29-5. The Port Authority of New York and New Jersey removed Labor Law §§ 240 and 241(6) claims by a worker injured during the demolition of the World Trade Center after September 11, on the grounds that these claims arose under the Air Transportation Safety and System Stabilization Act. That Act created a federal cause of action for claims "arising out of the hijacking and subsequent crashes" and gave the United States District Court for the Southern District of New York exclusive jurisdiction over those claims. The District Court concluded that the laborer's injuries, which were allegedly sustained as a result of a hydraulic claw machine dropping a steel girder, were not proximately caused by the events of September 11 and that the incident was no different than accidents on any other con-

struction site. The court found no evidence in the legislative history that a case so tangentially related to September 11 should be governed by the Act. Moreover, New York courts have extensive expertise in applying their laws and regulations regarding construction sites. The District Court remanded to the Supreme Court of the State of New York. *Graybill v. City of New York*, 2002 U.S. Dist. LEXIS 16891 (S.D.N.Y. 2002).

29-6. An elevator inspector performing a two-year safety inspection slipped on oil, fell and was injured. He commenced an action against the building owner under Labor Law § 241(6), alleging violation of the Industrial Code (12 N.Y.C.R.R. § 23-1.7(d)) regulating slipping hazards. The Court of Appeals affirmed dismissal on the ground that an actionable claim involving maintenance work must occur in the context of construction, demolition and excavation. *Nagel v. D & R Realty Corp.*, 99 N.Y.2d 98, 752 N.Y.S.2d 581 (2002).

29-7. Lessee's employee fell from a ladder while taking measurements for a proposed warehouse racking system subsequently installed by a third-party contractor. The injured employee's claim against the lessor under Labor Law § 240(1) was dismissed because he was not injured during "the erection, demolition, repairing, altering, painting, cleaning or pointing of a building or structure," thereby rendering section 240(1) inapplicable. *Ciesielski v. Buffalo Industrial Park, Inc.*, 299 A.D.2d 817, 750 N.Y.S.2d 246 (4th Dep't 2002).

29-8. A supervisor, employed by the municipal owner, was within the class of protected persons of Labor Law § 240(1) when he fell through a gap in the flooring. Because he was investigating ongoing construction work, he was engaged in work covered by the statute even if his actions at the time of his injury did not necessarily constitute "construction." Since his injury was "elevation-related," he was covered by Labor Law § 240(1). *Campisi v. Epos Contracting Corp.*, 299 A.D.2d 4, 747 N.Y.S.2d 218 (1st Dep't 2002).

MECHANICS' LIENS

29-9. A forum selection clause in a construction contract could require that a mechanics' lien be litigated in the contractually-designated forum and not in the county where the real property was located. The court relied upon CPLR 501, which permits enforcement of an agreement "fixing place of trial," and held that the forum selection clause trumped the seemingly mandatory language of CPLR 507, which holds that actions affecting real property shall be commenced in the county where the property is situated. *A.C.E. Elevator Co., Inc. v. V.J.B. Construction Corp.*, 192 Misc.2d 258, 746 N.Y.S.2d 361 (Sup. Ct., Kings Co. 2002).

PREVAILING WAGES

29-10. The Second Department concludes that General Municipal Law § 107 authorizes the Supreme Court to permit a contractor to post an undertaking or surety bond as security for the release of progress payment funds withheld by a municipal owner pursuant to a Notice To Withhold issued by the Department of Labor under Labor Law § 220-b(2)(b), asserting that the contractor's employees have been underpaid. *In re Rondout Electric, Inc. v. Monroe Woodbury Central School District*, 301 A.D.2d 113, 751 N.Y.S.2d 262 (1st Dep't 2002).

PUBLIC CONTRACTS

29-11. During the excavation work for a public project, a contractor rented concrete forms and shoring equipment from a leasing company. After the contractor defaulted on lease payments and the equipment was not returned, the lessor commenced an action against the contractor and surety to recover damages under the labor and material payment bond required by State Finance Law § 137. Under that statute, "material" encompasses items that the parties reasonably anticipated would be consumed during the project, but does not include capital equipment that could be used on subsequent projects. The surety was obligated to pay the rental payments on which its principal defaulted, but was not required to pay for the unreturned capital items. *Harsco Corp. v. Gripon Construction Corp.*, 301 A.D.2d 90, 752 N.Y.S.2d 59 (2d Dep't 2002).

29-12. Relying on existing judicial precedent, the State Comptroller concludes that it would be inconsistent with the multiple prime contractor requirement of General Municipal Law § 101 to permit a construction manager to also contract as a prime contractor on a public works project. Opns. St. Comp., No. 2003-17 (December 30, 2002).

STATUTES

29-13. Chapter 127 of the Laws of 2002—adds Article 35-E to the General Business Law, imposing standards for prompt payment of construction contracts on projects other than public works and residential development. Interest payment and suspension of performance remedies are made available in cases of improperly delayed payment to contractors, subcontractors and material suppliers. See the **Bulletin** introducing this edition on page 1. Effective January 14, 2003.

29-14. Chapter 242 of the Laws of 2002—amends section 220-g of the Labor Law and section 137(4)(b) of the State Finance Law to permit an underpaid employee to bring an action against the issuer of a payment bond on a public works project, in addition to the contractor

or subcontractor to which the employee furnished labor. Such action may be brought within one year from the date of the alleged underpayment, or within one year from the date the Commissioner of Labor or other fiscal officer files an order determining a wage or supplement underpayment. The action may, with the employee's permission, be brought by the Commissioner of Labor or other fiscal officer, in addition to an employee organization. Effective November 1, 2002.

29-15. Chapter 582 of the Laws of 2002—repeals and reenacts section 19(4) and section 21(5) of the Lien Law to permit the discharge of mechanics' liens on private or public improvement projects by filing surety bonds without any approving court order. The surety bonds must be issued by a fidelity or surety company authorized to conduct business and possessing a current certificate of qualification issued by the Superintendent of Insurance, which has not been revoked. In the case of a lien on a private improvement, the bond is filed with the clerk of the county in which the notice of lien is filed. In the case of a lien on a public improvement, the bond is filed with the state or public corporation with which the notice of lien is filed. In each case, the face amount of the bond must equal one hundred ten percent (110%) of the lien amount. A copy of the bond must be served on the lienor. The bond is effective to discharge the lien when filed and served. If the certificate of qualification is not filed with the bond, the lienor has ten days from receipt to serve a notice of exception challenging the sufficiency of the surety. If the bond is not issued by an authorized surety, approval of the sureties and discharge of the lien require a court order. The statute otherwise applies Article 25 of the CPLR to regulate undertakings for the discharge of private or public improvement liens. Effective January 1, 2003.

Construction & Surety Law Newsletter

This newsletter is published for members of the New York State Bar Association's Torts, Insurance and Compensation Law Section by the Construction and Surety Law Division. Attorneys should report decisions of interest to the Editor. Since many of the decisions are not in the law reports, lawyers reporting will be credited on their contribution.

ISSN 1530-3977

Construction and Surety Law Division
Torts, Insurance and Compensation Law Section
New York State Bar Association
One Elk Street
Albany, NY 12207-1002

NON PROFIT ORG.
U.S. POSTAGE
PAID
ALBANY, N.Y.
PERMIT NO. 155

ADDRESS SERVICE REQUESTED