



CONSTRUCTION LAW E-UPDATE

NYC'S CONTRACTUAL "PAYMENT GUARANTEE" MUST STRICTLY CONFORM TO STATUTORILY-REQUIRED PAYMENT BOND

By Henry L. Goldberg, Managing Partner, Goldberg & Connolly

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As we have often discussed, New York State Finance Law §137 requires all municipalities and the State of New York, and its agencies, to require a statutorily compliant payment bond on all public improvements projects with a contract value in excess of \$200,000. There are no exceptions. Nonetheless, for years the City of New York (the "City") has openly violated this law, without penalty, leaving subcontractors, suppliers, and tradesmen potentially at risk in the event of nonpayment by the general contractor or construction manager.

This has occurred in the context of the City's CM-Build projects. Instead of requiring GC's to furnish a payment bond from an independent surety company, the City substituted its own "payment guarantee" in its standard CM-Build prime contract, allegedly to provide equivalent-to-a-payment-bond protection, in the City estimation, to all subcontractors and material suppliers on its CM-Build projects. The City's payment guarantee stated that it is to be construed in a manner "consistent" with the rights and remedies provided to claimants by the legally required payment bond. In practice, however, the City has improperly denied valid claims against its payment guarantee for nonpayment based upon additional, unilaterally imposed contractual conditions that are not consistent with, and would not have barred claims against, a §137 payment bond.

Recently, however, in an action brought by Goldberg & Connolly on behalf of its client, Navillus Contracting, a New

York appellate court has ruled that the City's "additional obstacles" to recovery under the City's payment guarantee are invalid and cannot be utilized by the City to deny claims. The appellate court agreed with our argument that any provision in the City's payment guarantee imposing more stringent requirements than that which would be required under State Finance Law §137 bond are not enforceable by the City.

One of the more egregiously illegal conditions of the City's payment guarantee, is that unless and until the City actually denied a claim against its guarantee, subcontractors and material suppliers seeking payment under the guarantee were barred from filing a mechanics' lien and filing a lawsuit against the City for payment. According to the City's payment guarantee, having the audacity to file a mechanics' lien or lawsuit would automatically forfeit any right to making a claim against the City's guarantee. Moreover, the City's payment guarantee unilaterally prohibited a claimant from collecting the nine percent, pre-judgment interest otherwise allowed by law to any other successful litigant, and also barred any right to recover attorney's fees and costs against the City, no matter how frivolous the City's defense to the claim. None of these restrictions and prohibitions would be permitted under State Finance Law §137.

These unilaterally imposed requirements rendered the City's payment guarantee all but worthless to unpaid subcontractors and suppliers on these illegally "un-bonded"



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projects. Subcontractors working on City CM-Build projects had every reason to believe the City would obey the law and that it would routinely arrange for the providing of the §137 required payment bonds. Many potential claimants, therefore, were completely unaware that no payment bond was in effect until it was too late to meet the City's additional requirements. Furthermore, even if they were aware that the City was violating the law, and they attempted in good faith to comply with the City's additional requirements, as, for example, by holding off from filing a mechanic's lien until the City actually denied a subcontractors' payment guarantee claim, a claimant's time to file a mechanic's lien may, by that time, have already expired. Only the City could devise such an illegal Catch 22-type circumstance and then attempt to seriously defend it in court.

G&C Commentary

A debt of gratitude is owed to Navillus Contracting for funding and pursuing this appeal, and to the STA for its amicus curiae appellate brief in support. The appellate court's decision in favor of Navillus Contracting effectively eliminated the City's improper practice of denying payments to subcontractors and suppliers under its so-called payment guarantee when such claimants would otherwise have had timely valid claims under a §137 payment bond. At a minimum, potential claimants

should treat the City guarantee as an equivalent of a §137 bond and be certain to comply with all of the provisions of §137 when attempting to make claim against NYC's guarantee on a CM-Build project.

Finally, there is authority in New York for the proposition that on contracts for public improvements governed by §137 of the State Finance Law, where no statutory payment bond was required (and, regrettably, we have seen such projects), a claim for payment may still be brought directly against the public owner. One reported court decision in New York has held that a governmental body's failure to comply with §137 of the State Finance Law, and to have its prime contractor furnish the statutorilyrequired payment bond, provides the aggrieved claimant with a direct private right of action against the negligent municipality itself for the payment. In such case, however, the frustrated payment bond claimant should, again, be certain to comply with all of the requirements of §137 regarding the time to file a payment bond claim and/or sue on a payment bond.

In this decision, the good guys won, the City's "wrists were slapped" for its flagrant and knowing violation of State law, and the statutory payment bond protection of subcontractors, suppliers, material men and tradesmen was vindicated.