



# NYC's "CM Build" Projects Unlawfully Failed To Provide For Payment Bonds

## LEGAL LOG

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Many subcontractors and material suppliers engaged on New York City projects may be unaware that the City, in violation of New York law, has not required its construction managers to furnish the legally mandated payment bond guaranteeing prompt payment of moneys due to subcontractors and material suppliers on City-owned, public improvement projects. Although the City's practice is currently being challenged in state court, until this violation is corrected, subcontractors and material suppliers must undertake special precautions to safeguard their rights to payment.

State law requires all municipalities to have the prime contractor or construction manager provide a statutorily compliant payment bond on all public improvement projects with a contract value in excess of \$200,000. There are no exceptions. Nonetheless, instead of requiring construction managers to furnish a payment bond from a third-party surety company, the City has substituted its own contractual "payment guarantee" in the prime contract, allegedly for the benefit of all subcontractors and material suppliers for the project at issue.

The language within the City's payment guarantee states 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 reality, however, the City's guarantee imposes significant limitations and additional administrative requirements upon subcontractors and material suppliers who desire to make a payment claim against the contractual guarantee.

By example, the payment bond required by law does not impose any notice requirements on subcontractors or material suppliers in a direct contractual relationship with the general contractor or construction manager. The City's payment guarantee, however, requires notice of any claim within four months of non-payment. In addition, the City has imposed significant documentation requirements for a claim not required by the statutory bond including submission of all documentation the City "deems appropriate" and a notarized statement in support of the claim.

Other City-imposed burdens in bringing a claim against the guarantee are even more egregious. Unless and until the City denies a claim, subcontractors and material suppliers seeking payment under the guarantee are barred from filing a mechanics lien or a legal action against the City for payment. According to the City's contract, filing a lien or lawsuit will automatically forfeit any right to making a claim against the guarantee. This, too, is clearly in violation of New York State law.

Moreover, the City's payment guarantee unilaterally prohibits a claimant from collecting nine percent, pre-judgment interest otherwise allowed by law, and also bars any right to recovering attorney's costs and fees, no matter how frivolous the City's defense to the claim. None of these restrictions and prohibitions are permitted by the payment bond required by state law.

Fortunately, a subcontractor or material supplier whose claim may be barred by the specific terms of the City's payment

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guarantee may still be entitled to pursue a payment claim against the City.

One reported court decision has held that a governmental body's failure to comply with state law, and to have its construction manager furnish the required payment bond, affords an aggrieved claimant with a direct private right of action against the municipality for payment. According to that case, a claimant may be entitled to recover from the government any claim that would have been viable against the required payment bond, notwithstanding the additional requirements and restrictions the government may have unilaterally inserted into its payment guarantee.

Other New York court decisions have held that any limitation or other restriction that dilutes the minimum protection provided by the statutorily-required payment bond is not enforceable because such limitations violate public policy. According to the case law, any bond or contract that include provisions limiting a claimant's rights, will be "rewritten" by the court to provide the exact same minimum protection for payment established by law. In other words, recovery against the City's payment guarantee may be allowed if the claimant would otherwise be permitted recovery

against the statutorily-required payment bond, regardless of additional limitations imposed by the guarantee.

#### **G&C Commentary**

G&C has recently filed an appeal to the New York Appellate Division on behalf of a subcontractor client whose payment claim was denied by the City for alleged failure to comply with limitations imposed by the City's contractual payment guarantee. On behalf of its membership, the STA also plans to file an amicus curiae brief on this very important issue.

If successful, the payment bond rights of subcontractors and material suppliers on City "CM Build" projects will be clearly defined. In the interim, however, both diligence and caution is suggested. Find out if either payment bonds or NYC contractual payment guarantees have been issued. Understand all potential limitations that might bar a successful payment bond or payment guarantee claim. Pay special attention to notice requirements. If a contractual payment guarantee is provided by NYC instead of the statutorily required payment bond, help is on the way. Meanwhile, comply with the additional "burdens" the City has imposed to at least preserve what diminished protection the City's guarantee provides.

