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THE CONSTRUCTION AND SURETY LAW UPDATE

CONSTRUCTION • GOVERNMENT CONTRACT CLAIMS • SURETY • LABOR • LITIGATION

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Henry L. Goldberg
Managing Partner

THE NEW PROCUREMENT LOBBYING LAW

• Beware of the "Black-Out" Period

Imagine that your company was the low bidder on a multi-million dollar project and you were anxious, after learning that the award was "held up" for an undetermined reason, to obtain more information from the agency. Routinely, someone from your company would call a "friend" at the agency to find out what was going on.

However, a new state statute, effective January 1, 2006, strictly prohibits, during what can effectively be considered a "black-out" period, any communications between a contractor and a contracting agency that could be deemed to be intended to influence a procurement decision (i.e., award of the contract). This period runs from the earliest date of solicitation to ultimate award and comptroller approval.

The simple act of a contractor calling that "friend" at a New York State agency about a pending low bid can

Continued on page 2 ►

IN THIS ISSUE

- **The New Procurement Lobbying Law**
- Beware of the "Black Out" Period! 1
- **Change Orders With NYC Agencies**
- Insurance Costs - Workers' Compensation and Surety Bond Premiums Reinstated 5
- **The "Hybrid" Project - Private Improvement on Public Land** 4

LEGISLATIVE DEVELOPMENT

- "Damage for Delay" Bill Passes Senate 5

LABOR LAW

- **Limitations on Cross-Withholding of Project Funds** 6

SURETY LAW

- **Payment Bond Surety Held Liable For Attorneys' Fees** 6

FEDERAL CONTRACTING

- **When The Federal Government Goes Too Far**
- "Excessive Inspection" Claims 7

SPOTLIGHT ON THE FIRM

- **G&C Welcomes New Additions** 3

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Procurement Lobbying Law... (Continued from page 1)

now put the award at risk. If that friend is not the "designated contact person" and if that communication is for other than a very limited number of exempted topics, such contact could cause very serious problems for the contractor, including a loss of the opportunity to be awarded the contract. The new law creates strict disclosure requirements regarding any such contacts with state government personnel during the "black-out" period.

A "contact" is very broadly defined, under the statute as, "[A]ny oral, written or electronic communication with the governmental entity under circumstances where a reasonable person would infer that the communication was intended to influence the governmental procurement."

The critical "black-out" period (i.e., "Restricted Contract Period") runs from the earliest attempt to solicit a response with regard to a procurement contract to final contract award. However, final contract award means that all parties that must approve the contract have granted that approval. For instance, some contracts may require the approval of the State Comptroller or a legislative body. The "black-out" period will continue through the end of these extra approval periods.

Impermissible "Contacts" During "Restricted Period"

Impermissible contacts with the governmental entity occurs when the bidder contacts an individual at a state agency who is not the "designated contact person" for the particular procurement in an attempt to influence that agency. For example, the bidder contacts a person other than the designated representative of the agency and engages in a communication which a reasonable person would infer was intended to influence the procurement. Not only is this contact strictly prohibited, the agency employee is now required to record the event.

There are specific, limited exceptions. Submission of a bid, proposal or response for a procurement contract is clearly exempted, as are the submission of written questions (e.g., RFI's) but only when written responses are to be provided to all bidders. In addition, participation in a formal pre-bid conference or negotiations with a state governmental entity after a tentative award are permissible.

Government Agencies Covered

The new Procurement Lobbying Law is applicable to any attempt to influence contract awards once a procurement process has been commenced by any state agency (departments, boards, bureaus, commissions, divisions, offices, councils, committees and officers of the state, Public Authorities, Public Benefit Corporations, Industrial Development Agencies and Local Benefit Corporations). This covers quite a bit of territory. Included, for example, would be the New York State DOT, New York State OGS, DASNY, MTA and its subsidiaries, TBTA, NYC-SCA, NYS Thruway Authority, et al. Significantly, not covered as yet, are New York City, as well as other cities, towns, and counties.

The law also requires such governmental agencies to designate a person who generally may be the only staff member contacted relative to a particular procurement during the restricted period. It also requires a timely disclosure of accurate and complete information by bidders with respect to determinations of non-responsibility and debarment.

New Requirements Imposed Upon NYS Governmental Entities

As indicated, the new law requires state agencies to collect certain information about any person or organization contacting it about a procurement in attempts to influence same during the Restricted Period. However, in addition, state agencies must now obtain information from bidders about any findings of non-responsibility made within the previous four years by any other governmental entity and if the finding of non-responsibility was due to: (1) engaging in impermissible contacts during a "black-out" period, or (2) intentional provision of false or incomplete information to a governmental agency. It is also now the responsibility of the governmental entity to request such information in its original solicitation or initial bid documents.

In addition, there are new recordkeeping requirements imposed upon state agencies. A governmental entity contacted by an individual or company that reasonably appears to be attempting to influence the procurement during the "black-out" period must be disclosed and the contacted state agency must record the contact, obtaining the following specific information for each

Continued on page 3 ►

Procurement Lobbying Law... ... (Continued from page 2)

contact: name of the person and company, address, telephone number, place of principal employment, occupation, and whether the person making the contact was the bidder or a lobbyist retained by the bidder. All this information must be included in the procurement record for the project.

The New Law's "Teeth"

The State Finance Law now also requires a governmental entity to make a determination of responsibility before awarding a procurement contract. In addition to the classic responsibility factors such as financial and organizational capacity, integrity, and past performance, the State Finance Law now require state agencies to consider in responsibility determinations any prior violation of the "permissible contact" or disclosure requirements of the new law.

If it is found that the bidder had knowingly and willfully violated the State Finance Law in this regard, the bidder and any of its subsidiaries, related or successor entity will be determined to be a "non-responsible" bidder and shall not be awarded the contract. This is an extremely harsh penalty. Furthermore, a subsequent finding of non-responsibility by the vendor or contractor within four years prior to the determination of non-responsibility will result in the vendor or contractor becoming ineligible (i.e., debarred) to submit a bid or receive an award in any procurement with the state for four years from the date of the second finding of non-responsibility.

Even more significant is the fact that a state agency is now precluded from awarding a contract to a bidder that has been determined to be non-responsible because of a willful violation of the prohibitions against impermissible contacts unless the state entity finds that a limited exception is applicable. This exception only applies to narrow circumstances where the procurement contract is "necessary to protect public property or public health and safety" and where the bidder is "the only source capable of supplying the required article of procurement within the necessary time frame."

G&C Commentary:

It is hard to imagine making a call to a state agency or authority about a pending award, and by that same informal inquiry losing any chance of receiving the very

Spotlight On The Firm . .

Goldberg & Connolly is pleased to welcome several new associates and colleagues to our Construction, Commercial Litigation and Real Estate Practice Groups.



Mitchell B. Reiter, Esq., joins the firm as a Senior Associate. Most recently he was in his own private practice and prior to that a senior litigator at Winick & Rich, P.C. He has over fifteen years of experience in commercial litigation.



Brian P. Craig, Esq., formerly a partner at Mohen, Craig & Treacy, LLP. Mr. Craig has extensive knowledge and practical experience in commercial litigation, surety law, construction law and government contracting matters.



John C. Abili, Esq., formerly an associate with Treacy, Schaffel, Moore & Mueller, focuses his practice on construction law and commercial litigation. Mr. Abili practiced law in Nigeria for nine years prior to coming to the United States and completing his Master of Laws program at Howard University Law School.

We also welcome two new staff members -



Lawrence J. Doyle, our new Director of Administration. Mr. Doyle joins G&C with over twenty years of law firm administration experience. He is an active member of the Association of Legal Administrators and also has his Master's Degree in Public Administration and Government Affairs.



Bernice Augustus, has close to ten years of paralegal experience, the majority at a large NYC firm. She has a B.S. Degree in Criminal Justice from St. John's University.

award about which the caller was originally concerned. Being formally found "non-responsible" as well, with all the ramifications that entails, certainly appears to be overkill.

(Continued on page 4 ►)

Procurement Lobbying Law... ..(Continued from page 3)

This is a dramatic change in NYS procurement law. One can only question if New York legislators, not expert in government contracting, really appreciated the far-reaching implications and limitations imposed by this new "Procurement Lobbying" Law. The law has numerous harsh provisions - not the least of which is the requirement that the contractor: (1) be found non-responsible, and (2) not be awarded the public contract in question for a knowing and willful violation during the "black-out" period. Similarly the requirement that the contractor be debarred for four years is a virtual death sentence. The ramifications of this law are so severe, in fact, that we caution all contractors to receive advice of counsel before attempting to contact a state agency during a "black out period" for any procurement.

Inquiries to the NYS Lobbying Commission or the Advisory Council on Procurement Lobbying clearly indicate that the state government is still grappling with the full implementation of this significant new law. Not all questions regarding implementation have been resolved, but for now, caution is strongly advised.



THE "HYBRID" PROJECT - PRIVATE IMPROVEMENT ON PUBLIC LAND

• Contractors Now Protected By Bond

One of the frustrating loopholes in the Lien Law is the inability of claimants to lien privately funded projects on public land. Private improvement liens are filed against the land itself, while public improvement liens are filed against the public funds underlying a public works project. Public land cannot be liened. Since no public funds are typically utilized on private projects which improve public land, commonly referred to as "hybrid" projects, no public improvement lien can be filed against any public funds either. Therefore, neither a private improvement lien nor a public improvement lien can be filed on a "hybrid" project.

A recent amendment to the New York Lien Law attempts to mitigate this "Catch 22" result, and closes this loophole in part. It marks the second time the New York Legislature has attempted to address this problem. In 1992, the New York Legislature amended Lien Law

§2(7) to permit contractors and suppliers to file private improvement mechanics' liens against the real property owned by an Industrial Development Agency ("IDA"), which are privately funded. In other words, the legislature carved out an exception to the lien law for one type of hybrid project, those owned by IDAs.

Now, the legislature has determined to provide contractors, subcontractors and suppliers with improved protection in all but the smallest of hybrid projects. Effective November 17, 2004, the legislature amended §5 of New York's Lien Law to require that all private owners post a surety bond or other form of undertaking guaranteeing payment on privately funded projects located on publicly owned land when the estimated construction costs exceeds \$250,000. This is a major advancement in closing this loophole. As a result of the amendment, unpaid contractors, subcontractors and suppliers will henceforth have the additional security of being able to assert what is in essence a payment bond claim on "hybrid" projects.

G&C Commentary:

The "hybrid" project may now be a type of job that a contractor, subcontractor or supplier no longer needs to avoid. We would still like to see mechanics' lien rights on all hybrid projects, not just IDA funded projects. However, the new amendment may, in fact, provide contractors and suppliers with more readily accessible protection than they would otherwise have on projects which are lienable, since suing on a payment bond is ordinarily an easier remedy than having to go through the formalities of foreclosing on a mechanic's lien.

Another issue is the lack of certain important details in the legislation. Who is to enforce the provision and what are the consequences of not providing, or timely providing, the required bond? How are potential lienors to be advised of the existence of the bond and to receive copies of same?

In addition, be sure to note that this Lien Law amendment does not set forth any minimum or specific terms for the bond. It is essential, therefore, to ascertain the terms of the bond because there may be critical provisions (especially notice provisions and/or suit limitation periods within which an action must be commenced) in the bond which must be carefully followed in order to assert and preserve a claim against the surety on the bond.



CHANGE ORDERS WITH NYC AGENCIES UNDER ARTICLE 26

• Insurance Costs For Surety Bond Premiums and Workers Compensation Reinstated

As previously reported on these pages, when New York City developed its Standard Construction Contract (Oct. 2000) its formula for the pricing of change orders in Article 26, - "Methods of Payment for Extra Work," was significantly modified without fanfare or opportunity for public comment. All job related insurance costs - liability insurance, surety bond premiums and even workers compensation premiums were dropped as a compensable direct expenses. Instead, they were "deemed" to be overhead to be compensated at the very same 10% rate as was provided when all insurance premium costs were paid as a direct expense.

In effect, as we have previously described it, the City was cramming "20lbs of manure into a 5lb bag." The same 10% overhead rate was all that was provided to absorb the job - specific insurance costs were now deemed to be overhead.

This was clearly an error. Since no public hearings were conducted prior to the change of this important contract provision, it took a while for its effects to "bite." It wasn't until 2001 that new public contracts contained this revised Article 26 and it took another few years for change order controversies to percolate through the system. Knowledgeable City personnel privately acknowledged there was an error. Job specific insurance costs that would not have been incurred by a contractor, but for the specific project, are clearly direct costs (as was recognized in the original Article 26) and not overhead. However, the bureaucracy moved slowly and resisted change.

This clear injustice was recently remedied after 16 months of effort by the Subcontractor Trade Associations' (STA) Public Agency Committee. At a meeting between the STA's Committee and the Mayor's Office of Contract Services (MOCS), Marla G. Simpson, Director of MOCS, announced that on or before February 28, 2006, the City would be revising Article 26 of the Standard City Contract to include insurance costs for worker's compensation and performance surety bonds.

Legislative Developments

SENATE PASSES PROHIBITION AGAINST "NO DAMAGE FOR DELAY" CLAUSES

By: Henry L Goldberg

In 1998, I had the privilege of co-chairing an industry-wide coalition to develop legislation which would prohibit the use of "no damage for delay" (NDFD) clauses in public works contracts in New York State. This important government reform legislation was well received in Albany. The bill passed the Senate unanimously that year, and passed the Assembly by all but four votes. After deliberating for over six months, Governor Pataki eventually vetoed the bill. In doing so, however, he expressed his agreement with its purpose and intent.

As Governor Pataki prepares to leave office at the end of 2006, there is a strong sense among industry leaders that this is the year to revisit the issue in force.

Efforts this year are off to an excellent start. On March 15th, the New York Senate passed our 2006 bill (S2893B), unanimously. On May 9th, I attended an industry coalition meeting in Albany, among representatives from the GCA, STA, NYBC, CIC, LICA and ESSA, which met with Assembly Speaker Sheldon Silver. It was clear that the Assembly, having overwhelmingly passed the bill before, is sympathetic and supportive of the current bill (A2723B). The key component to a successful campaign will ultimately be Governor Pataki. As indicated, he has publicly stated his agreement in principle with the bill's purpose and intent. Furthermore, the 2006 version of the bill specifically addresses each and every technical concern the Governor expressed in his veto message.

This is clearly one of the most important pieces of government reform legislation to directly impact public works contractors in years, perhaps decades. We will be looking for your support as the bill clears the Assembly and heads for the Governor's desk. This is not a time to sit on the sidelines and hope others carry the day. Call your trade association, your Assemblyman or the Governor's office today.

Continued on page 6 ►

G&C Commentary:

This is a great start and congratulations are due the STA's Public Agency Committee. However, the City did not go far enough and has not yet agreed to include general liability, automobile and builders risk insurance premiums into the "direct costs" category, as they were so designated in the original Article 26. These job specific costs are not overhead and must be compensated for directly. However, for now a wrong has been partially righted and contractors will be fairly treated with regard to job specific insurance costs on change orders, at least to the extent of worker's compensation and surety bond premiums.



LABOR LAW

LIMITATIONS ON CROSS-WITHHOLDING OF PROJECT FUNDS TO ENFORCE PREVAILING WAGE LAW

General contractors recognize the New York Labor Law insures that if a subcontractor on a project does not pay the correct prevailing wages and benefits to its workers, the New York State Department of Labor ("DOL") can look to the general contractor to make good for its sub's underpayment. The DOL through its Bureau of Public Works can direct the contracting public agency to "withhold" moneys due the general contractor on the particular job where the sub's workers were not properly paid. In addition, consistent with the terms of most public work contracts and the New York Labor Law itself, in certain cases, the DOL can "cross-withhold" by directing the hold-up of money owed to the general contractor on an unrelated job to secure an underpayment on the original, audited project.

In 2002, however, New York's highest court, the Court of Appeals, held that the NYS - DOL's Bureau of Public Works cannot recover wages that the employer failed to pay on one project from moneys otherwise due that employer on another (unrelated project), if any trust fund beneficiary on the unrelated project had not

yet been paid.

The Court of Appeals explained that this cross withholding limitation is directly related to workers' rights to wages under the New York Lien Law § 70. The New York Lien Law Article 3-A trust impressed on project funds prevents the DOL from using the money for workers on an unrelated project by cross-withholding. Although, the Court of Appeals noted the DOL's claim that the public owner has a contractual right to withhold the funds from the general contractor, the Court held that the claims of the Lien Law Article 3-A trust beneficiaries are stronger than that of a Labor Law §220 (prevailing wage law) claimant. As the Court stated, "a comparison of the literal language of Labor Law § 220-b (2) (a) (1) with that of Lien Law § 70 (1) reveals that the Article 3-A trust is broader and may arise prior to the existence of any funds to which DOL's notice of cross-withholding could attach." (Id. at 939.)

G&C Commentary:

It appears that New York's Lien Law Article 3A Trust Fund provisions outweigh New York's Labor Law §220. However, it should be noted that the provisions of New York's Lien Law which preclude cross-withholding until all trust fund claimants on an unrelated project have been paid, have no counterpart under federal statutes. The United States DOL, in enforcing the federal Davis Bacon Act, have no such limitations and can lawfully direct a federal agency to withhold funds from the prime contractor and/or cross-withhold funds from an unrelated federal project that the audited prime contractor is also working on.



SURETY LAW

PAYMENT BOND SURETY HELD LIABLE FOR ATTORNEYS' FEES

In what is generally viewed as the exception rather than the rule, a unanimous panel of a New York appellate court held that a subcontractor could recover interest and attorneys' fees from the Payment Bond Surety.

Section 137(4)(c) of the State Finance Law

Payment Bond Surety... (Continued from page 6)

provides, in part, that a court may (i.e., within its discretion) award attorneys' fees to either party when, upon review of the entire record, it appears that either the original claim or the defense interposed to such claim is without substantial basis in fact or law.

In this case, a subcontractor sought to collect from the payment bond surety the value of a change order work it performed for the general contractor on a New York City Transit Authority project. The surety denied the claim, we (and the Court) believe unreasonably. The surety hopelessly maintained that the change order work was of such a nature that it was "not fairly within the contemplation of the parties at the time of the original underlying contract was made...", and thus no labor and materials for the change order was covered under the payment bond.

Bad faith claims against the sureties are an ugly business, and, in any event, counterproductive since New York law is extremely "conservative" in this regard and almost never countenances when finding compensable bad faith against a surety. However, the award of attorneys' fees on a payment bond claim does provide some opportunities for the claimant that has been recently dealt with by a surety to achieve some redress. When is this available? This 2001 appellate court decision provides some insight into the thinking of New York Courts.

The appellate court unanimously held that the change order work was not only similar in nature to the work performed under the base contract, it was "indispensable to the achievement of the contract's essential purpose." In so ruling, the court concluded that the contractor should be reimbursed for its attorneys' fees and interest because the surety's defense to payment was "without substantial basis since there was no plausible ground for its claim that the change order in question was not issued pursuant to the covered contract..." The court distinguished a total lack of any plausible grounds for a defense from a merely unsuccessful defense, which would not, if supported by the facts or the law, form the basis for a recovery of attorneys' fees.

G&C Commentary:

The appellate court seems to be adopting a similar test to that which is used under court rules in New York State for the imposition of sanctions against law firms

for frivolous litigation. Surety counsel has a right and obligation to vigorously defend an unjustified payment bond claim. However, counsel exposes its surety client to interest and attorneys' fees when it really "churns" a case for no good reason other than to prolong litigation and delay the proper processing of a valid payment bond claim.



FEDERAL CONTRACTING

WHEN THE FEDERAL GOVERNMENT GOES TOO FAR

• "Excessive Inspection" Claims

A recent Court of Federal Claims decision has confirmed the current federal law concerning (1) when a government inspection becomes overly burdensome to a contractor; and (2) when such "burdensome inspections" constitute a breach of the government's duty to: (a) exercise good faith and (b) not to hinder contract performance.

The case in point involved the termination for default of a contractor who was frequently behind schedule in its production, as well as in its delivery schedule, for air crewman survival vests. In addition, the government was forced to reject numerous vests for deficiencies discovered during inspections.

The contractor countered that the government breached its duties to exercise good faith and not to hinder performance of a contract by conducting unreasonable inspections and failing to cooperate. In ruling that the inspections, while thorough, did not rise to the level of bad faith and the hindering of performance, the Court reiterated the key tests necessary to determine when inspections do, in fact, become too burdensome.

One of the keys to this discussion is a general understanding of the standards for the government's implied duties of "good faith" and "not to hinder performance." The Court articulated the distinction between both standards. Generally, the failure of the government to affirmatively cooperate with a contractor in the performance of a contract serves as a breach for failure to exercise good faith. However, the duty not to hinder performance is breached when the government

Continued on page 8 >

Federal Contracting..

(Continued from page 7)

commits actions that unreasonably cause delay or hindrance with respect to contract performance.

Interestingly, although the Court decided that the facts in this particular case were insufficient to meet the standards discussed above, it made clear that had the contractor not been so deficient in its performance, the outcome might have been different.

The Court shed light on this issue by citing previous case law and by outlining the types of government inspections that will be characterized as violating the government's dual duties of "good faith" and "not to hinder." The Court specifically delineated that these duties would be violated in the following examples: (1) where the inspector acted rigidly and arbitrarily disregarded the inspection plan agreed to by the government's inspection supervisor and the contractor; (2) where the inspector created new inspection points and procedures which unreasonably inconvenienced the contractor; (3) where the inspector inappropriately spoke with the contractor's employees regarding product defects; (4) where the inspector engaged in arduous inspections by demanding a higher quality product than required by the contract; and (5) where the inspector failed to promptly inspect the product or refused to allow the contractor to view the inspection procedure.

G&C Commentary:

While the Court in this case declined to find that the strict standards for asserting an "excessive inspection" claim were met, it made clear that a cognizable cause of action does exist given the right set of facts. However, reading between the lines, the Court made clear that while in theory "excessive inspection" should not be determined by the contractor's quality of work, but by the government's misdeeds, the lack of adequate performance by the Contractor might color a court's analysis. Where the government arbitrarily disregards inspection plans, substantially increases the amount of inspections for no apparent reason or causes unreasonable inconvenience to an otherwise capable contractor, the contractor can and should consider challenging the government's actions.

IN OUR NEXT ISSUE

Comptroller Alan Hevesi seeks implementation of a state-wide "VENDEX" to replace the New York State Uniform Contractor Questionnaire to be known as VENDREP. This is consistent with the Comptroller's recent intensified review of contract awards by state agencies and authorities. - look for details in our next edition.



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We would love to hear your comments and suggestions.

Julie J. Wytzner
Editor

Either e-mail us at
admin@goldbergconnolly.com,
use the enclosed 'FAXBACK' sheet,
or simply call us at 516-764-2800.

G&C Building
66 North Village Ave.
Rockville Centre, NY 11570

www.goldbergconnolly.com

*Warm thanks and acknowledgements to our
contributing attorneys and staff:*

*John C. Abili, Esq. Janet M. Connolly, Esq.
Brian P. Craig, Esq. Mitchell B. Reiter, Esq.
Julie J. Wytzner*

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