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Construction In Brief

A quarterly publication brought to you by COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

Good News for Contractors: Right to Cure Performance Upheld in *Milton Regional Sewer Authority v. Travelers Casualty & Surety Co. of America*

By Jason A. Copley and Matthew R. Skaroff

In April of this year, the United States Court of Appeals for the Third Circuit addressed the question of when, under Pennsylvania law, an owner may ignore a right-to-cure provision in terminating a construction contract and assert a claim against the contractor's performance bond. In the case of *Milton Regional Sewer Authority v. Travelers Casualty & Surety Co. of America*, the Court held that an owner may only ignore this contractual right to cure when the contractor has committed an incurable breach, such as in instances of fraud.

In *Milton*, a municipal authority entered into a contract for a public works project, with the contractor's performance secured by a performance bond. The contract provided that, before the owner could terminate the contractor for any problems, the owner needed to provide the contractor with thirty days' notice to cure. Significantly, the performance bond did not allow the owner to recover from the surety if it failed to comply with the terms of the contract.

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What's New

Brief Note:

Greetings from the Editorial Team at Construction In Brief! We are excited to share the news that George Pallas will be our new Managing Partner. Don't miss the New York Office Q&A, where he discusses the expansion of the Firm's footprint. We are also covering a recent decision, Milton Regional Sewer Authority v. Travelers Casualty & Surety Co. of America, bringing good news for Pennsylvania Contractors. We also discuss important insurance coverage issues on New Jersey projects.

We hope you will enjoy this last issue of the year and wish you a wonderful new year!

Ashling
Co-Editor-in-Chief

Jennifer
Co-Editor-in-Chief

Allie
Associate Editor

By Kerstin Isaacs

New Managing Partner

We are pleased to announce that **George Pallas** will become Managing Partner effective January 1, 2017. A founding member of the Firm, George currently serves as treasurer and member of the Firm Board. He counsels a wide range of construction clients including general contractors, subcontractors, and suppliers on both public and private projects. George handles matters involving commercial, industrial, institutional and residential construction, heavy highway, water supply and treatment, solid hazardous waste, school and various other multi-prime projects.

New Faces

Please join us in welcoming new associates across two of our offices: **Mary Kate Emert** and **Thomas Raccuia**.

Mary Kate Emert joins the Firm as an Associate in the Construction Group in Philadelphia. Kate was a summer associate last year and we are happy to welcome her back. While at Temple University Beasley School of Law, Kate was a Comment Editor for the International and Comparative Law Journal and a Fellow of the Rubin Public Interest Law Honor Society. Kate also brings litigation experience as a paralegal at a large New York City firm.

Thomas Raccuia joins the Firm as an Associate in the Construction Group in New York, where he concentrates his practice in construction litigation. Prior to joining Cohen Seglias, Thomas's practice was focused in construction labor law litigation and professional liability litigation. Thomas graduated from Fordham University School of Law, where he was an Associate Editor of the Fordham Law Review.

Community Service

Cohen Seglias has always been committed to improving the heart health and overall wellness of our employees and their families. This year, **Ed Seglias** was a member of the Executive Leadership Team for the Philadelphia Heart Walk and was joined by more than 50 employees and family members raising funds for the **American Heart Association's** walks in Philadelphia and Pittsburgh.

The Firm continues its commitment to support **Habitat for Humanity's** mission to help families achieve the dream of home-ownership by building safe, sustainable and affordable homes. The Cohen Seglias Build Team recently worked at Habitat Philadelphia's Diamond Park site.

Kerstin is the Firm's Marketing Director. She can be reached at (215) 564-1700 or kisaacs@cohenseglias.com.

NJ Supreme Court Gets It Right!

Consequential Damages Caused by Subcontractors' Defective Construction Work Is Insured

By Jonathan A. Cass and Rene D. Quinlan

The New Jersey Supreme Court's August 4, 2016 decision in *Cypress Point Condominium Association, Inc. v. Adria Towers, LLC* opened the door for general contractors to obtain insurance coverage under their commercial general liability (CGL) policies for property damage caused by their subcontractors defective work after the project was completed.

In *Cypress*, a condominium association sued the general contractor and several of its subcontractors, alleging that water infiltration in roofs, windows, and common areas discovered after the project was completed caused damage to the structural steel, sheathing, drywall, insulation and floors of the newly-constructed building. The association claimed that the damages were caused by the subcontractors' faulty construction. When the general contractor's CGL insurance companies denied coverage, the association joined the insurance companies into the lawsuit.

The insurance companies moved to dismiss the association's claims, taking the position that the subcontractors' faulty workmanship was not an "occurrence" that caused "property damage" under the terms of the CGL policy. Specifically, the insurance companies argued that CGL policies are only intended to provide coverage for damage to property *other than* the project itself. They further asserted that subcontractors' defective workmanship was not an "accident" that gives rise to an "occurrence" under an insurance policy; rather, the subcontractors' defective workmanship is a normal consequence of the construction business.

The association, on the other hand, argued that although New Jersey courts have long held that defective construction is not covered under an insurance policy, damages that are a *consequence* of the defective construction *are* covered. It also pointed to the "your work" exclusion contained in the 1986 (and after) version of the CGL coverage form. While property damage to a *general contractor's own work* is excluded under its CGL policy, an exception to the "your work" exclusion provides coverage for property damage to the project caused by its *subcontractors'* defective work that occurred *after* the completion of that work (e.g., under the policy's completed operations coverage).

The New Jersey Supreme Court agreed with the association. The Court found that the water infiltration and resulting property damage was an "occurrence" under the CGL policies and was caused by an "accident," because there was no evidence that the subcontractors *intended* to cause any of the damage. The most important consideration for the Court was the subcontractor exception to the "your work" exclusion contained in the CGL policies, and the fact that the damage *resulted from* the subcontractors' work.

The practical implications of the *Cypress Point* case are extremely significant for general contractors who have CGL policies issued in New Jersey. If your CGL policy contains an exception to the "your work" provision for your subcontractors, your insurance company may be required to defend you in a lawsuit and pay for the damages *resulting from* your subcontractors' defective work, so long as the damage took place after the work was completed. It is important to note that the insurance company will not be required to pay to repair your subcontractors' defective work, but it may be required to pay for damages that are a *consequence* of that defective work.

To determine whether or not your CGL policy contains a subcontractor exception to the "your work" exclusion for completed operation coverage, or provides coverage in any particular instance, you should always consult with your attorney and insurance broker.

Jonathan is a Partner in the Firm's Commercial Litigation Group and Rene is a Senior Counsel in the Firm's Construction Group. They can be reached at (215) 564-1700, jcass@cohenseglias.com and rquinlan@cohenseglias.com.

Green Building Contracts:
Key Issues to Consider

By Lane F. Kelman and Michael Metz-Topodas

No longer labeled a fad, green building holds an established place in the construction industry. Green building refers to designing and constructing buildings that consider impacts on the environment and the community, such as energy use, water use, indoor environmental quality, and construction materials. Because of these unique considerations, green building contracts and projects can entail risks and concerns not commonly faced in traditional jobs. Successfully negotiating these risks includes considering the following issues.

What Type of Form Contract is Used?

Using form contracts is an industry convention. But many of these form contracts predate the development of green building standards and lack provisions and clauses necessary for green building projects. Thankfully, industry organizations, such as the American Institute of Architects, are creating form contracts specifically tailored for green building projects. The wise contractor makes sure to use these forms when agreeing to work on a green building project.

What Green Building Standard Must the Project Meet and How Will That Standard Be Measured?

Green building projects often aim to have a final building that meets one or more environmentally-oriented standards, such as energy efficiency. Typically that standard reflects or incorporates those established by an independent organization, such as those the United States Green Building Council requires for Leadership in Energy and Environmental Design ("LEED") certification. Whatever standard used, the contract should state clearly the project's measurable benchmarks. For example, a requirement that a contractor construct a "green and sustainable building" lacks sufficient specificity. In fact, a similar provision led to an owner-initiated litigation in Illinois, where a residential architectural contract included an objective to achieve "a sustainable green modern single family home," and the owner claimed the architect breached the contract by failing to obtain LEED Certification. As this case illustrates, such vague language can invite disputes and potentially costly litigation.

Who Has Responsibility to Ensure the Project Meets Required Green Building Standards?

In addition to articulating precise standards, a green building contract needs to designate who has responsibility for meeting those standards. Design professionals and contractors each play roles in whether a building achieves the requisite standard. Determining how the contract apportions that role poses a challenge because of designers' and contractors' adverse interests. Designers do not want to take on full responsibility for achieving green building standards because contractors may not implement their designs properly. Contractors also do not want full responsibility lest they take on liability for faulty designs. This tension presents great potential for risk and exposure: where the project fails the required green building standard, all will look to blame each other. Further complicating the issue, green building requirements often include a separate certification from an independent organization—yet another stakeholder in the process.

When Must Green Building Standards Be Achieved? What Happens When They Are Not?

Like traditional construction contracts, timing plays a significant role in green building projects. First, an owner may need particular green building standards achieved by a certain date to take advantage of regulatory incentives, such as tax credits. In addition, green building benchmarks need a definite duration. For example, a requirement to achieve LEED certification should limit how long a contractor or designer bears responsibility for the building meeting requirements for that certification. If not, the agreement may create a virtual indefinite warranty. Finally, in the event an owner tries to claim a green building requirement was not reached, the contract should exclude consequential damages, such as increased energy costs.

Do the Project Plans Align With Green Building Standards?

Green building projects carry another potential risk: that a contractor bears responsibility for how a building performs, not just whether the contractor built it according to plans. Typically, where the owner's architect (or engineer or both) provides the project design, the *Spearin Doctrine* protects the contractor from liability for project flaws as long as the contractor followed the project design. Green building projects, however, often have performance standards, such as energy efficiency ratings, not merely design requirements.

No case has yet applied the *Spearin Doctrine* to protect contractor liability for a building's failure to meet green building requirements, even where the contractor completes the project as designed. Consequently, a contractor may face liability where the as-built project does not achieve contractual requirements for sustainability. Before committing to achieving green building standards, contractors need to ensure that the project as planned can and will lead to a building that meets those requirements. Contractors should have an independent consultant review project plans with attention to this issue, in particular when the contractor performs value engineering or is working as a team with the developer and engineer or architect.

What Federal, State, or Local Regulations Apply to the Project?

Federal, state, and local laws and regulations either require meeting sustainability standards or providing worthwhile incentives for such construction. To the extent such regulations apply, contractors need to make sure their contracts comply. Failing to do so could result in regulatory interference to ensure compliance—creating delays and complications that increase cost but which could have been avoided.

Although green building projects entail their own unique set of issues, with proper guidance, those issues should not discourage contractors from taking advantage of the business opportunities such projects provide. For guidance on issues related to specific green building projects, consult an attorney.

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Good News for Contractors:

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By Jason A. Copley and Matthew R. Skaroff

As the project progressed, the owner became dissatisfied with the contractor and sent a letter ordering it to suspend its work. The contractor offered to correct any failures in its work, which the owner rejected. The owner then terminated the contract. After termination, the owner incurred additional costs to complete the project and asserted a bond claim against the surety to recover these costs. The surety refused to pay the owner, citing to the improper termination. The owner then filed suit against the surety, which ultimately went to the Third Circuit on appeal.

The Third Circuit ruled that, by terminating the contract without giving the contractor its contractual right to cure, the owner had breached the contract and was therefore not entitled to recover from the surety. It found that when a contract provides a contractor with a right to cure, the owner must allow the contractor to do so unless the contractor's breach is "so serious [that] it goes directly to the heart and essence of the contract, rendering the breach incurable." The court noted instances of fraud as one such example, but found that, in this case, "poor performance is not incurable." It also recognized that the contractor was willing to fix its deficiencies if given the opportunity.

Milton reaffirms several points of law in Pennsylvania. For one, it recognizes that a contractor generally has a right to cure its defects when the contract allows it. Additionally, the *Milton* case recognizes that, when provided for in the contract, owners have an obligation to provide contractors with a reasonable opportunity to cure, notwithstanding a serious, material breach. Moreover, common breaches by contractors and subcontractors, such as costly defects in workmanship, delays, and non-payment to suppliers or subcontractors, will likely not be sufficient to justify a termination without first providing an opportunity to cure. Indeed, all of these breaches could possibly be remedied with repaired work, an increased labor force, or payment. Both owners and contractors alike should follow right-to-cure provisions in their contracts, as a failure to do so may limit recovery for legitimate damages incurred as a result of a deficient contractor or subcontractor.

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New Overtime Requirements Put on Hold by Nationwide Injunction

By Steven M. Williams and Joshua Brand

On November 21, 2016, a federal district judge issued a nationwide injunction blocking the implementation of the new overtime regulation issued by the U.S. Department of Labor that was set to take effect on December 1, 2016. The regulation would have expanded the obligations for employers to pay overtime compensation to their employees by, among other things, doubling the minimum salary threshold required to qualify for the "white collar" exemption under the Fair Labor Standards Act ("FLSA"). For now, employers can breathe a sigh of relief as their impending obligations to comply with the regulation have been put on hold, at least temporarily.

Background of the Overtime Rule

The FLSA requires that certain employees receive time and one-half of their regular pay when working more than 40 hours in a given week. In 1954, the U.S. Department of Labor ("DOL") issued regulations that set forth the criteria employees must meet in order to be considered "exempt" from the FLSA overtime requirements. Generally, employees must pass three tests in order to be exempt: (1) the compensation test, which requires that an employee earn at least $23,660 per year ($455 per week); (2) the salary basis test, which requires that an employee be paid on a salary basis only, defined as a pre-determined amount of compensation paid to an employee each pay period which cannot be reduced based on quality or quantity of work performed; and (3) the job duties test. As it pertains to the "job duties" test, there are three categories of "white collar" classifications that are exempt from the overtime requirements: Executive, Administrative, and Professional. Whether an employee fits within one of these classifications under the "white collar" exemption is based upon an examination of the specific job duties of the employee.

The Proposed New Regulation

In May 2016, the DOL issued a regulation that would expand the number of employees entitled to receive overtime pay. Under the new regulation, the salary threshold to qualify for an exemption would increase by more than 100%, to $47,476 per year ($913 per week). That means that to be exempt from overtime pay (and presuming the job duties and salary basis tests are met), an employee must receive a salary of at least $47,476 per year. If implemented, the economic impact on employers of the regulation would be enormous. It was expected that over 4 million currently exempt employees would become non-exempt, and thus, entitled to overtime. That would translate into an estimated $12 billion in new wages to be paid by employers nationwide to newly non-exempt employees.

The Injunction and What it Means for Employers

After the DOL passed the regulation, 21 states and a coalition of business associations brought lawsuits seeking to block its implementation. These cases were consolidated into one case in the U.S. District Court for the Eastern District of Texas. On November 22, 2016, the judge presiding over the suit issued a preliminary injunction against the DOL from implementing the regulation. Prior to the injunction, many employers were bracing themselves for the impact of the new regulation. Some employers increased the pay of their currently exempt employees in order to meet the increased minimum salary threshold. Now, these same employers will face the tough dilemma of whether to rescind the salary increases that have been given or promised to their employees – a decision that will surely affect employee morale.

Conclusion

While the preliminary injunction does not end the litigation, it does mean that until further action by the Court is taken, the new regulation will not take effect. The DOL indicated that it will appeal the Court's injunction. With the new Trump administration in tow, observers will be watching closely to see how the litigation will play out under a Trump-appointed Labor Secretary. If the injunction is lifted, employers will need to evaluate their positions and make decisions about whether to reclassify exempt employees as nonexempt, pay additional overtime, reduce hours, bring on more workers, or simply absorb the increased costs. For the time being, however, employers should continue to comply with the existing regulations.

Steven is the Chair of the Firm's Commercial Litigation Group and a member of the Firm's Labor & Employment Group. Joshua is an Associate in the Firm's Labor & Employment Group. Steven can be reached at (717) 234-5530 or swilliams@cohenseglias.com, Joshua can be reached at (215) 564-1700 or jbrand@cohenseglias.com.

Q&A with Our New York Office

George E. Pallas

Shawn R. Farrell

Carol A. Sigmond

Our newsletter team recently sat down with the members of our New York office.

Q: Tell us a little about Cohen Seglias in New York.

A: George — This is an exciting time for the Firm. We have served clients in New York for a long time, but we are now seeing an increase in our caseload and are expanding our footprint in the area. Shawn and I are spending more time there and we hired Partner Carol Sigmond, current President of the New York County Lawyers Association (NYCLA). We are fortunate to have found her as she brings substantial construction litigation experience in both the public and private sectors as well as experience in contract preparation, mediation, suretyship, bid protests, appeals, and arbitration. With the opening of our new downtown Manhattan office, we are in the process of hiring both support staff and attorneys. Just last month, construction Associate Thomas Raccuia joined the New York team. Our 5,000 square foot office on the 9th floor of 55 Broadway offers great views of the city and is a perfect space for us during this time of growth. The location is conveniently close to both the courts and all of the subway lines.

Q: What services can the New York office offer the Firm's clients?

A: Shawn — With our new downtown office and over a dozen of the Firm's attorneys licensed to practice in New York, we are ready to assist our clients in any New York matters. We can serve our clients on the same wide range of construction projects that we have assisted with for decades, like high rises, marine work, bridges, schools, and water treatment plants. Our services cover any construction project in both the public and private sectors. In addition, because we have offices in several states, we can use this broad platform to reduce the cost of litigation by outsourcing time-consuming administerial tasks to geographical regions that offer lower hourly billing rates. I welcome the opportunity to discuss these advantages with any existing or future client.

Finally, our New York office offers services to our clients in other practice areas, such as labor and employment, real estate, business transactions and commercial litigation.

Q: Why did you decide to join Cohen Seglias?

A: Carol — I had grown my solo practice to the point where I had to make a decision to hire staff or join a firm. I needed the administrative and marketing infrastructure and would frankly rather practice law! As I was wrestling with this hard decision, I met George Pallas, and got to know him and Cohen Seglias as a firm. I liked the platform Cohen Seglias offered, it spared me the administrative work and it gave me an opportunity to do a more varied and larger scope of work. Everyone at the firm has been very welcoming.

Q: How did you start your career in construction law?

A: Carol — I had no plans to go into construction law when I was a young summer clerk at a personal injury firm in Arlington, Virginia, but one day I was pulled into a case involving a gruesome car accident. The car had hit an exposed manhole cover ring. I immersed myself in reports and pictures as well as witness interviews. We ended up suing the transit authority and the contractor who had dropped the street around the ring and not placed temporary asphalt as required. In the process, I discovered that I had a knack for the science and engineering that is needed in construction cases.

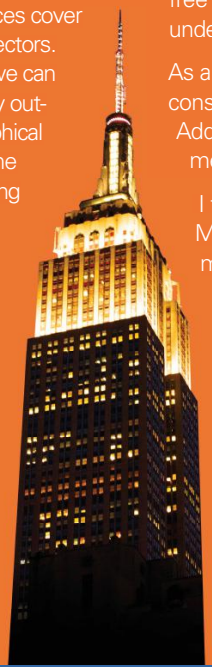
Q: You are the President of the New York County Lawyers Association. Tell us about the Association and your role there.

A: Carol — NYCLA is the largest county bar association in the state of New York with approximately 9,000 members. The Association's founding principle was inclusion: anyone admitted to practice law in New York State was eligible to join, without regard to race, religion, gender or national origin. Founded in 1908, NYCLA's purpose was to promote a judiciary free from political cronyism and committed to equal justice under the law.

As a non-partisan association, we bring lawyers together to consider common professional, ethical and business concerns. Additionally, we provide training, issue reports and statements, and provide pro bono opportunities for our members.

I function as the CEO of NYCLA with a full-time staff of 28. My role covers both mentoring and talent identification. I make several hundred appointments a year and interact with members, judges and legal journalists alike. Both at NYCLA and at Cohen Seglias, I try to encourage the young lawyers to look at themselves as practicing lawyers early on in their careers and not just as lawyers in training. It is important to instill in all lawyers a sense of professionalism which includes thinking independently and ethically for the benefit of our clients.

Members of our New York office can be reached at (212) 871-7400.



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