ASA's THE CONTRACTOR'S Compass

THE OFFICIAL EDUCATIONAL JOURNAL OF THE AMERICAN SUBCONTRACTORS ASSOCIATION

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Construction Court Cases You Ought to Care About

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THE CONTRACTOR'S Compass

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EDITORIAL PURPOSE
The Contractor's Compass **is the monthly educational journal of the Foundation of the American Subcontractors Association, Inc. (FASA) and part of FASA's Contractors' Knowledge Network. The journal is designed to equip construction subcontractors with the ideas, tools and tactics they need to thrive.**

The views expressed by contributors to *The Contractor's Compass* do not necessarily represent the opinions of FASA or the American Subcontractors Association, Inc. (ASA).

EDITORIAL STAFF
Editor-in-Chief, Marc Ramsey

MISSION
FASA was established in 1987 as a 501(c)(3) tax-exempt entity to support research, education and public awareness. Through its Contractors' Knowledge Network, FASA is committed to forging and exploring the critical issues shaping subcontractors and specialty trade contractors in the construction industry. FASA provides subcontractors and specialty trade contractors with the tools, techniques, practices, attitude and confidence they need to thrive and excel in the construction industry.

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EDITORIAL SUBMISSIONS
Contributing authors are encouraged to submit a brief abstract of their article idea before providing a full-length feature article. Feature articles should be no longer than 1,500 words and comply with The Associated Press style guidelines. Article submissions become the property of ASA and FASA. The editor reserves the right to edit all accepted editorial submissions for length, style, clarity, spelling and punctuation. Send abstracts and submissions for *The Contractor's Compass* to communications@ASA-hq.com.

ABOUT ASA
ASA is a nonprofit trade association of union and non-union subcontractors and suppliers. Through a nationwide network of local and state ASA associations, members receive information and education on relevant business issues and work together to protect their rights as an integral part of the construction team. For more information about becoming an ASA member, contact ASA at 1004 Duke St., Alexandria, VA 22314-3588, (703) 684-3450, membership@ASA-hq.com, or visit the ASA Web site, www.asaonline.com.

LAYOUT
Angela M Roe
angelamroe@gmail.com

PRESIDENT'S LETTER

Dear ASA Members:

Last month, after an exhaustive, six-month search, the ASA Search Committee—composed of the ASA Executive Committee members—named government relations expert Michael T. Oscar as its director of government relations, effective immediately. I cannot emphasize enough how excited the ASA Board of Directors is about Mike and his team from Gray & Oscar, LLC, a government relations consulting firm with offices in Alexandria, Va., and Philadelphia, Pa., where Mike is managing partner. The Gray & Oscar team includes Timothy Ward, ASA government relations communications director, and Shannon Oscar, ASA task force director.

Mike will lead ASA's government and industry advocacy programs, including federal legislation, government regulations, and industry collaboration and coalitions. Of course, Mike will have big shoes to fill, but we are confident that Mike and his team will successfully execute our strategic legislative action plan and accomplish our advocacy goals, including cultivating and establishing new industry alliances.

Mike has nearly 20 years of experience in government affairs and 12 years of service on Congressional staff. During his tenure on Capitol Hill, he worked in both Republican and Democratic offices in the U.S. House and Senate, giving him rare institutional knowledge of both chambers and caucuses. His bipartisan experience in Congress has equipped him with a unique set of contacts and networks to access on behalf of ASA.

In both public and private practice, Mike has been deeply involved in key construction subcontractor issues, including prompt payment, the mechanic's lien law, government procurement, funding for apprenticeship training programs, public-private partnerships, and worker misclassification. His regulatory experience spans multiple federal and state agencies, including the Environmental Protection Agency (lead paint remediation), International Trade Commission (tariff), Occupational Safety and Health Administration (workforce safety and silica and beryllium exposure limits), and the U.S. Department of Labor (bid solicitations, worker misclassification, overtime regulations and National Labor Relations Board rulings), Commerce (economic development), and Agriculture (risk management and international trade). And, as a representative for a national construction trade association, Mike successfully spearheaded an effort to secure a U.S. Court of International Trade decision regarding aluminum extrusions for curtainwall units.

At Gray & Oscar, Mike has represented major construction trade associations for over a decade. The Gray & Oscar team has broad and extensive background in local, state and federal government, as well as judicial and executive branch and political and non-profit campaign experience.

I am also excited about Mike's successful track-record on implementing ASA priorities at the state level. In Pennsylvania, for example, Mike was instrumental in developing a bipartisan coalition of lawmakers to implement the state's prompt pay law, as well as an update to the mechanic's lien law. The Pennsylvania Prompt Pay law was enacted under divided government with overwhelming bipartisan majorities.

ASA is charting a new path into the future, and it's an exciting time for ASA. We have an entire team devoted not only to our advocacy and industry initiatives, but also our growing Chapter Network. Mike and his team will be a tremendous resource and advocacy coach for our 30-plus chapters across the country, and he will work closely with our chapters to establish and maintain effective grassroots advocacy programs.

Please join me in welcoming Mike, Tim and Shannon to our Association!

Best Regards,

Courtney Little, 2018-19 President
American Subcontractors Association

2019 SUBExcel
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SUBExcel 2019 Education Workshop to Discuss 3D LiDAR Scanning and Drone Photogrammetry

Subcontractors will learn about some of the most exciting new technologies to be used in construction, 3D LiDAR scanning and drone photogrammetry, in a newly added contractor education workshop during ASA's annual national convention. "Reality Capture for Existing Conditions—SaveTime, Lower Risk," presented by David F. Dengler and Garrett Maldoon, Kelar Pacific, San Diego, Calif., will be offered from 10:30 a.m. to 11:45 a.m. on Friday, March 8, 2019, during SUBExcel 2019. SUBExcel 2019 "Technology—for Millennials to Dinosaurs" will take place March 6-9, 2019, at the Renaissance Nashville Hotel in Nashville, Tenn. Register online, make your hotel reservations, explore the program, and read about the speakers at www.subexcel.com. The early-bird deadline ends **Feb. 1, 2019**, and the hotel cutoff date is **Feb. 6**. New technologies including 3D LiDAR scanning and UAV/UAS drone photogrammetry deliver the real existing conditions to your computer faster and safer than traditional methods. Consider the amount of man-hours you invest in multiple site visits to obtain somewhat realistic laser and tape measurements. Learn how reality capture levels the playing field for any size firm.

David F. Dengler is passionate about both aerial and terrestrial Reality Capture solutions that produce accurate existing conditions. Along with being a licensed FAA 107 UAV/UAS (drone) pilot, Dengler conducts CEU presentations and helps educational institutions bring Reality Capture and CAD/BIM solutions into their classrooms. He has extensive real-world experience combined with a technical background. Dengler worked for Vectorworks Inc., a 3D modeling software, and founded his own iOS app development company, Illudium Q-36. Dengler has held project designer/manager positions with various California and Maryland architectural firms for over 15 years. His design experience spans both residential and commercial projects.

Garrett Maldoon is an AEC technical specialist at Kelar Pacific. As the Job Captain for in-house projects, Maldoon manages project coordination activities and performs BIM modeling for construction ranging from residential to commercial to healthcare. Maldoon provides field services including 3D LIDAR Scanning and Point Layout. He continually looks for ways to connect the field to the digital environment using VR/MR/XR technologies. Maldoon uses his knowledge to teach Revit classes and to support the team by creating Revit content.

Reintroduction: Discussion Draft Change Orders Legislation

Despite the government shutdown and the start of the new 116th Congress, ASA is yet again partnering with the Construction Industry Procurement Coalition in drafting a discussion draft "change orders" legislation that would amend the Government-wide Federal Acquisition Regulation to provide prospective construction contractors with the following:

- Information on bid proposals and the administration of construction contracts;
- Improvement on payment protections for subcontractors; and
- It would prohibit the use of reverse auctions for design and construction services.

Ultimately, this discussion draft will include three sections that will be very important to the ASA Membership, and they are:

- Equitable adjustments to construction contracts,
- Provide certainty regarding claims under federal construction contracts, and
- Pre-Bid transparency of federal construction services.

More specifically, on the Equitable Adjustments to Construction Contracts Section, we anticipate the draft language will mirror legislation introduced by Rep. Fitzpatrick (R-PA) in the 115th Congress, which would do the following:

- Require agencies to report during the solicitation process when it is the agency's policy or procedure to bundle change orders for approval and payment at the end of the job, long after the contractor has completed the work.
- Require an agency to pay for 50 percent of the actual (incurred or committed) cost to perform change order work.

Under ASA's former Chief Advocacy Officer E. Colette Nelson's leadership, ASA worked directly with CIPC and Rep. Fitzpatrick on this legislation and on May 25, 2017, Nelson testified on this issue at a House Small Business Committee Hearing.

As the draft discussion legislation continues to matriculate through the drafting process in anticipation of a formal introduction within the next few weeks, I will keep you posted on it. Finally, ASA's collaboration with the CIPC on this important legislation will be paramount and the CIPC involves the following groups:

- American Council of Engineering Companies
- American Institute of Architects
- American Society of Civil Engineers
- American Subcontractors Association
- Associated General Contractors of America
- Construction Management Association of America
- Council on Federal Procurement of Architectural and Engineering Services
- Design-Build Institute of America
- Independent Electrical Contractors
- Management Association for Private Photogrammetric Surveyors
- National Association of Surety Bond Producers
- National Electrical Contractors Association
- National Society of Professional Surveyors
- Sheet Metal and Air Conditioning Contractors National Association
- The Surety & Fidelity Association of America

Partial Government Shutdown Update

The partial government shutdown that is impacting a quarter of the government and nearly 800,000 federal employees has surpassed the previous 22-day shutdown record in 1996, with little progress being made to resolve the political stalemate. The issue separating Republican and Democratic Leadership is President Trump's request of $5.7 billion from Congress to fund a border wall between the United States and Mexico. President Trump has made it clear that he will veto any spending package sent to his desk if border wall fund is not included. Democratic Leadership has refused to give in to the president's funding request. In one of her first acts as Speaker of the House, Speaker Pelosi (D-CA) called up a package of bills on the first day of the 116th Congress that would reopen the government. The package, which has now passed the House multiple times this month, does not include funds for the border wall. Senate Majority Leader McConnell (R-KY) has refused to consider any House Package without border wall funding, knowing that it will be met with a veto from the president.

Earlier this month, President Trump made his first Oval Office address to the American people, which was met with a rebuttal from Speaker Pelosi (D-CA) and Senate Minority Leader Schumer (D-NY). Both President Trump and the Democratic Leadership ended their speeches by demanding the other side bring an end to the shutdown. Over the course of several weeks, negotiations between President Trump and Democratic Leaders have been few and far between, resulting in little progress to resolve the conflict.

While the government remains partially shutdown, the U.S. Department of Labor remains open, with normal operations for unemployment benefits and OSHA. The Social Security Administration is also fully operational which is allowing benefit checks to go out on time. Both agencies received their full funding for fiscal year 2019 last September, allowing them to remain open. However, ramifications are beginning to affect the day-to-day operation of the country, including the closing of the Small Business Administration (SBA). The closure of the SBA means small businesses are unable to move forward on public contracts, delayed payments and the inability to obtain SBA loans. Finally, per Kevin Hassett, Chairman of the White House Council on Economic Advisors, "the shutdown is estimated to cut U.S. economic output by 0.1 percent every two weeks."

IRS Issues Proposed Regulations on New Business Interest Expense Deduction Limit

The Internal Revenue Service has issued proposed regulations for a provision of the Tax Cuts and Jobs Act, which limits the business interest expense deduction for certain taxpayers. Certain small businesses whose gross receipts are $25 million or less and certain trades or businesses are not subject to the limits under this provision. For tax years beginning after Dec. 31, 2017, the deduction for business interest expense is generally limited to the sum of a taxpayer's business interest income, 30 percent of adjusted taxable income and floor plan financing interest. Taxpayers will use new Form 8990, *Limitation on Business Interest Expense Under Section 163(j)*, to calculate and report their deduction and the amount of disallowed business interest expense to carry forward to the next tax year. This limit does not apply to taxpayers whose average annual gross receipts are $25 million or less for the three prior tax years. This amount will be adjusted annually for inflation starting in 2019. Other exclusions from the limit are certain trades or businesses, including performing services as an employee, electing real property trades or businesses, electing farming businesses and certain regulated public utilities. Taxpayers must elect to exempt a real property trade or business or a farming business from this limit. Taxpayers may rely on the rules in these proposed regulations until final regulations are published in the Federal Register. Written or electronic comments and requests for a public hearing on these proposed regulations must be received within 60 days of publication in the Federal Register.

Construction Cases in the Courts You Ought to Care About—and Why

by R. Russell O'Rourke, Esq., Meyers, Roman, Friedberg & Lewis, LPA

You are from Missouri—or any other state for that matter—and you read about a construction case that has gone to court here in The Contractor's Compass. You say to yourself, why would I possibly care about a case from Ohio, California, Texas or, again, any state other than yours? You say, show me why that case is important to me.

Truth be told, some cases are immediately important to you, others may not seem so, but have a long-term effect that could be neutral, helpful or devastating to your company and other subcontractors and suppliers in your state. You ask yourself, "How is this possible, how can a Kentucky or Arkansas case be of interest to me?"

Something like that happened this October in Ohio. There is an Ohio Supreme Court case written about in this edition, *Ohio Northern University v. Charles Construction Services, Inc.* This was a case of first impression with the specific issue being considered, whether the language of the Commercial General Liability policy purchased by Charles Construction covered Charles Construction for defective workmanship caused by a subcontractor under the subcontractor exception to the "Your Work" exception or would the court follow the same logic that it did in its 2012 decision in *Westfield Insurance Company v. Custom Agri Systems, Inc.*? In Charles, the defective construction was performed by a subcontractor. In *Westfield*, the defective construction was caused by the insured.

When the court published its decision in *Westfield*, it held that, "Claims of defective construction or workmanship brought by a property owner are not claims for 'property damage' caused by an 'occurrence' under a commercial general liability policy." While that decision put Ohio in the minority of states that ruled on CGL claims in that way, it was after all, a claim against an insured which could be argued was not an occurrence because of the "Your Work" exception. Was Charles different? The court didn't think so. How did the justices come to the conclusion that, "… property damage caused by a subcontractor's faulty work is not fortuitous and does not meet the definition of an 'occurrence' under a CGL policy?" They didn't even get to the subcontractor exception because in both Westfield and Charles they agreed with, "our sister court in Kentucky" and "In deciding Custom Agri, we adopted the Arkansas Supreme Court's reasoning …"

What do the laws of Kentucky and Arkansas have to do with the laws of Ohio? Nothing. Courts look to other courts where there is "precedential value" to a case, meaning that another court decided this and we are subject to the authority of that court, so, generally, we need to follow it or determine why it is different from our case so we don't have to. In Ohio, the Ohio Supreme Court issues rulings that have to be followed by all lower courts; courts of appeal, one step up from trial court and one step down from the Supreme Court have precedential authority over trial courts within their jurisdiction; trial court decisions have no precedential value, not even in the same court with the same judge in another case.

What if a case isn't from a court within the jurisdiction of the court making the decision, but there is a case from another jurisdiction? While cases like that may not have precedential value, they may still be persuasive. The court may not have to follow the ruling, but it may want to do so. Perhaps the case, in the court's eyes, is particularly well-reasoned or is so similar to the case under consideration AND there is no case which is "on point" within the jurisdiction of the court deciding the case, that they want to adopt all or part of that prior ruling.

Such a decision can have an interesting effect. In Charles, the Ohio Supreme Court noted that, "After [the Arkansas] decision, the Arkansas legislature enacted [a new statute] which states that a CGL policy offered for sale in Arkansas shall define 'occurrence' to include '[p]roperty damage * * * resulting from faulty workmanship.' If it were so inclined, the Ohio General Assembly could take similar action in response to our opinion today." Essentially, the Court was saying that, "this is the current state of the law in Ohio as we see it and, if the people of Ohio don't think that it is right, then the legislature should change the law."

The same thing can and does happen in your state, for exactly the same reason. Should you care what happens in Ohio, Kentucky or Arkansas? The answer should be a confirmed, Yes!

Which cases should you care about? Generally, ones that you may hear about from your colleagues or you read about in the local news or in industry journals that have made what you think is a bad ruling that can hurt the way you do business or that are making new law or supporting existing law that might be appealed. You want to keep "good" laws and change "bad" laws.

That is the entire point of ASA's Subcontractor's Legal Defense Fund—to fund amicus, "friend-of-the-court," briefs to help the court understand not only the issues in the case, but how a decision will impact the construction subcontracting community. The SLDF searches for cases that are making rulings that are either harmful or helpful to subcontractors. If they are bad, we want

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FEATURE

Prompt Pay Act Poison Pills: High Interest and Attorney Fees

by R. Scott Heasley, Esq., Meyers, Roman, Friedberg & Lewis, LPA

Prompt Pay Acts can serve as a blessing or a curse for subcontractors and suppliers.

The blessing: If a general contractor refuses to pay for a subcontractor's work after it has received payment from the owner, the subcontractor can recover 18 percent interest and possibly attorney fees.

The curse: If a subcontractor or supplier refuses to pay its own subcontractor or supplier, they could face the same penalties.

A 2017 11th District Court of Appeals case, *Xtreme Elements, LLC v. Foti Constr., LLC*, illustrates the blessings and the curses that can crop up in large scale commercial construction projects. The case involved the construction of a K-12 school facility. The school district entered into an $800,000 contract with general contractor Foti Contracting, LLC. Thereafter, the general contractor hired subcontractor, Xtreme Elements, LLC, to construct an 18-inch thick, monolithic sidewalk pour and perform other work on the project. The project was designed with an 18-inch-thick sidewalk between a ball diamond and a parking lot. For perspective, highway concrete is often 11 inches thick and airport runways capable of handling international flights is 17 inches to 20 inches thick. The subcontractor then contracted with a concrete supplier, Associated Associates, Inc.

Near the end of the subcontractors' work on the project, the owner voiced concerns regarding the sidewalk project. The school district and its owner's representative were concerned the sidewalk had a "cold joint." Cold joints can occur when concrete starts to set before additional concrete is added, potentially causing a weakness in the concrete. The subcontractor believed the sidewalk was structurally sound. The subcontractor said it would consider removing the sidewalk if core samples demonstrated there was separation. The owner disagreed, required that Foti replace the sidewalk. When Xtreme refused to do the work, Foti hired a replacement contractor to complete the work and purchased the ready mix from the original supplier. The owner refused to pay Foti for the additional work, Foti refused to pay Xtreme for the sidewalk and other work in dispute and the subcontractor refused to pay its supplier.

The Xtreme filed suit against the Foti seeking damages for breach of contract and related claims. To add to the mix, the ready mix supplier filed a separate action against Xtreme in a different court, which was then consolidated with the first lawsuit. Xtreme counterclaimed against the supplier for breach of contract by failing to timely deliver all of the loads of concrete causing the alleged cold joint.

The subcontractor and the supplier each sought additional damages under, Ohio's Prompt Pay Act. The act requires contractors, subcontractors and suppliers to pay their subcontractors and suppliers within 10 days of receipt of funds associated with the subcontractor's work. If the party that received payment refuses to pay the lower tier within 10 days from the date funds were received *without just cause*, the unpaid party can recover 18 percent interest for all improperly retained funds. The act applies up and down the food chain in construction projects: subcontractors can sue general contractors, suppliers can sue subcontractors, sub-subcontractors can sue subcontractors, suppliers can sue suppliers, etc. If the party is not paid within a total of 30 days from the date funds were received, again *without just cause*, the prevailing party can, in the court's discretion, recover its reasonable attorney fees incurred in collecting the due, yet unpaid amount.

The Ohio Supreme Court has held one of the primary purposes of the Prompt Pay Act is to ensure that contractors pay subcontractors and materialmen for their work or materials in a timely manner. However, the Ohio General Assembly intended also to protect contractors by permitting them to withhold payment, or some portion thereof, due the subcontractor where a dispute arises related to the work performed or material provided by the subcontractor or materialman and for contractually agreed retainage.

The trial court in the *Xtreme* case had to grapple with several issues as it assessed the Prompt Pay claims.

First, the court had to decide what amounts were due and owing to the subcontractor and the supplier. The court determined the owner unjustifiably withheld $19,723.99 in payments to the subcontractor. However, the judge did not award Prompt Pay Act interest because the money was withheld to resolve a dispute involving the work performed. "Courts have determined that prejudgment interest under R.C. 4113.61 is not warranted when the contractor withholds the money 'in good faith' on a disputed claim." While the owner was required to pay the $19,723.99, the trial court held an interest award was not warranted because there was a good faith dispute regarding the "cold joint" issue.

Next, the trial court held an award of attorney fees was not warranted. While the statute requires the court to award attorney fees if payment was improperly withheld, the statute also provides four exceptions, specifically ORC 4113.61(B)(3) provides that, "The court shall not award attorney fees…if the court determines, following a hearing on the payment of attorney fees, that the payment of attorney fees to the prevailing party would be inequitable."

The judge, who heard evidence during the bench trial, did not hold a separate hearing on the issue of attorney fees because, presumably, he was well aware of the underlying facts of the case. His 22-page Judgment Entry the Court contained a one and one-half page, clear and concise discussion of the prompt pay claims, specifically finding that while prompt pay interest was due to both Xtreme and the ready mix supplier, that it would be inequitable to award attorney fees.

Xtreme appealed for the first time. The court agreed with Xtreme and ordered the judge to hold a formal hearing on the attorney fees. The appellate court held the hearing was specifically required by the statute. Therefore, the Appellate Court held that while the court could have specified that he was going to take evidence on attorney fees without holding a

Legally Speaking, cont'd.

to help assure that they are overturned. If they are good, we want to help assure that they *are not* overturned.

Read *The Contractor's Compass*—I must be preaching to the choir here, since you actually are reading it—and ASAToday, paying special attention to the cases that are being discussed and especially all SLDF cases. To keep up on what the SLDF is doing and the successes ASA is achieving for you, go to ASA SLDF Cases on the new ASA Web site to read the briefs that were filed and the resulting decisions. You can read the cases by state. You will notice that some states have many more cases that the SLDF has undertaken. This is primarily because more people are noticing and reporting cases of interest to the SLDF in those states.

If you read or hear about any cases that are from your state's courts, you should be VERY interested in those and should complete and submit an SLDF application to ASA for consideration. The SLDF, which is funded by your donations, spends thousands of dollars every year to help keep good laws and overturn bad laws for the benefit of you and the other members of the construction subcontracting industry. Remember, the SLDF has always operated completely on donations from ASA members and other interested parties—we cannot do this without you! Make a donation now to the SLDF!

R. Russell O'Rourke, Esq., is a partner with Meyers, Roman, Friedberg & Lewis, LPA, Cleveland, Ohio, where he serves as chair of the Construction Group. As legal counsel for The Builders Exchange and Home Builders Association, O'Rourke's 30-plus years of active involvement in construction industry trade associations—understanding both the requirements of the law and the business savvy to successfully operate within the industry—have allowed him to serve in the roles of client and industry advisor, advocate and leader. His active engagement has also translated into driving and contributing to legislative issues for the benefit of the construction industry, recognizing the issues that are most important to his clients and advising them of various approaches and resolution options using good business judgment. O'Rourke represents contractors, subcontractors, suppliers, homebuilders and remodelers throughout all stages of the process—"cradle to grave"—bidding, contract negotiation, change orders, claims and claims avoidance, mechanics' liens, bond claims and dispute resolution. He can be reached at (216) 831-0042, Ext. 153, or rorourke@meyersroman.com.

separate hearing, merely using the information from the bench trial did not suffice. When the case was remanded, the trial court promptly (pun intended) held a hearing and re-issued a nearly identical Order regarding the attorney fees.

Xtreme appealed again. Here, the court followed the Ohio Supreme Court's 2004 decision in *Masiongale Electrical-Mechanical, Inc. v. Construction One, Inc.* to hold that the award of attorney fees is to be determined within the court's discretion on a case-by-case basis considering all of the facts. Here it is important to note that this means that the decision is within the trial judge's discretion, so you cannot be certain of the outcome until the judge makes the decision, and then the Court of Appeals will review it only on an abuse of discretion standard, which is difficult to overcome.

Finally, the trial court held the subcontractor was liable for breach of contract for refusing to pay its supplier. However, the court determined prompt pay interest was not warranted from the subcontractor because, like the dispute between the general contractor and the subcontractor, there was a genuine, good faith dispute between the subcontractor and its supplier, but found that the contractor was unjustly enriched by the suppliers' concrete and retaining it without payment would be unjust. Therefore, while the subcontractor did not violate the Prompt Pay Act, the contractor did and was ordered to pay the 18 percent interest to the supplier.

The Xtreme case is a cautionary tale. When disputes arise, it is important to consider whether the disputes relate to workmanship or procedural issues like improperly recording a mechanic's lien. If there are not legitimate questions regarding workmanship, a contractor who withholds payment to a subcontractor or material supplier further down the line does so at great peril. Eighteen percent interest and an award of attorney fees can make a bad situation much, much worse.

For subcontractors and suppliers, prompt pay acts are a blessing as they provide leverage against an unreasonable contractor, when that contractor is withholding payment without cause. Keep in mind, however, a subcontractor can face a prompt pay claim of its own if it does not pay its material suppliers or sub-subcontractors.

Check with your construction lawyer to determine if your state has its own version of Ohio's Prompt Pay Act that your company can use to its advantage when payment issues arise.

R. Scott Heasley, Esq., is an attorney with Meyers, Roman, Friedberg & Lewis, LPA, Cleveland, Ohio. Heasley's practice encompasses representing public and private companies in commercial and general civil litigation and transactional matters. He also represents individuals, families, professionals, and businesses in all phases of dispute resolution including mediation, arbitration, and appeals before state and federal courts. Heasley represents lending institutions in workouts, foreclosures, and bankruptcy matters and defends clients in business disputes, motor vehicle accidents, and transportation matters involving towing and cleanup fees. He also represents plaintiffs in civil cases involving property disputes and collection matters. Heasley has handled multiple housing court matters, representing both plaintiffs and defendants, throughout his career. His transactional experience includes counseling private companies, partnerships, and individuals on their business transactions such as entity formation, contract drafting and review, buy-sell agreements, leasing, and commercial real estate transactions. He can be reached at (216) 831-0042, Ext. 115, or sheasley@meyersroman.com.

FEATURE

ASA Submits 'Friend-of-the-Court' Brief in Ohio Court Case, Urging Court to Limit Awards Greatly in Excess of Legitimate Claims in Breach of Contract Cases

by American Subcontractors Association

ASA, along with The Surety & Fidelity Association of America, submitted a "friend-of-the-court" brief on Jan. 4, 2019, asking the Ohio Supreme Court to limit awards greatly in excess of legitimate claims in breach of contract cases involving multiple defendants.

The case—*Waverly City School District Board of Education v Triad, et al*—involves a lawsuit arising out of a $6 million remediation to three Waverly City, Ohio, schools built in the early 1990s. The Waverly City School District and Ohio Schools Facilities Commission had, on the eve of the running of the statute of limitations, sued all entities involved in any fashion in the underlying construction.

During discovery, the defendants found that rather than allocating damages with reasonable certainty as to each defendant, the owner instead simply had its experts identify all parties involved in the construction of each item of work that ultimately was replaced in the remediation.

By the eve of trial, the owner had settled with the architect, the roofer's surety, the roofer's insurer, the roofing materials supplier, and the construction manager. The total value of the settlement coming to the owner for its $5.2 million in recoverable remediation costs (plus $800,000 in agreed upon betterment) was in excess of $10.5 million, yet the trial court was informed by the owners that they still had $3.4 million in claims left to litigate notwithstanding this excess recovery. The trial court granted summary judgment in favor of two remaining contractors, holding that the owners had been made whole by previous settlements and failed to properly allocate damages among the defendants with reasonable certainty.

The appeals court reversed, claiming that the owners can recover damages beyond the amount received in settlement from the settling co-defendants and that they are not required to allocate damages among co-defendants. The defendants have appealed the case to the Ohio Supreme Court and ASA has joined them in requesting intervention and a favorable ruling on their behalf.

In the *amicus* brief, ASA maintains that the appeals court decision conflicts with well-established law that a plaintiff is entitled to be made whole, but not recover a windfall. By opening the door for litigants to receive massive windfalls with no relation to actual damages, the decision would encourage and prolong costly litigation and impact construction contractors, subcontractors, and bonding companies with potentially devastating results.

The case involves matters of great public and general interest and profoundly affects ASA, its member companies, and the thousands of subcontractors and material suppliers working on construction projects of all sizes throughout Ohio. ASA encouraged the court to accept jurisdiction, reaffirm the well-established contract law principles that have been thrown into disarray by *Waverly* and reverse the Court of Appeals.

R. Russell O'Rourke, Esq., Meyers, Roman, Friedberg & Lewis, Cleveland, Ohio, prepared the brief for ASA. ASA's Subcontractors Legal Defense Fund financed the brief. Contributions to the SLDF may be made online.

Each year, courts across the country hand down hundreds of decisions on federal and state laws, as well as court-made or "case" law, that apply to subcontractors' businesses. Many of the decisions impacting subcontractors interpret the contract provisions of subcontract agreements—provisions like pay-if-paid, hold-harmless, duty-to-defend, and no-damages-for-delay. Some of these decisions are precedent-setting and carry significance for subcontractors across state lines.

ASA's Subcontractors Legal Defense Fund supports ASA's critical legal activities in precedent-setting cases to protect the interests of all subcontractors. ASA taps the SLDF to fund *amicus* curiae, or "friend-of-the-court," briefs in appellate-level cases that would have a significant impact on subcontractor rights.

From its inception, the SLDF has been involved in many landmark decisions, starting with its first case in 1997, *Wm. R. Clarke Corporation v. Safeco Ins.*, which prohibited pay-if-paid clauses in California. For a summary of recent cases ASA has been involved in, read ASA's SLDF Activity Report.

Texas Court's Ruling in Painter Case Poses Problems for Subcontractors That Operate Carpooling Programs

by Brian K. Carroll, Esq., Sanderford & Carroll, P.C.

Recently, the Texas Supreme Court has decided a case that has potentially wide-reaching consequences to any subcontractor that operates a carpooling program. Under the recently decided case of *Painter v. Amerimex Drilling I, Ltd.*, subcontractors can be on the hook for any accident that occurs during a company sponsored carpooling trip to or from work. This is problematic because it creates a potential coverage gap and exposes a subcontractor to direct liability for personal injuries where no liability exposure previously existed.

The case involved an oil and gas contractor, Amerimex Drilling I, Ltd. Sandridge Energy, Inc. hired Amerimex Drilling I, Ltd. to drill wells on a ranch in west Texas. Amerimex provided bunkhouses for its employees; but, Sandridge did not allow Amerimex to put the housing on the ranch. So, Amerimex put the housing about 30 miles away from the ranch. The Sandridge/Amerimex contract mandated that Amerimex pay the crew driller $50 per day to drive Amerimex's employees to the jobsite.

On Feb. 28, 2007, a crew driller was driving three Amerimex employees home when the driller struck another vehicle, which resulted in a rollover that killed two of the employees and injured the driver and the other passenger. The driver sought workers' compensation benefits, and he was found to have been in the course and scope of employment. The injured passenger and the two deceased passengers did not seek workers' compensation benefits, and when Amerimex sought to determine whether workers' compensation covered the injuries, a court determined that Amerimex lacked standing to bring the action.

Painter, the injured passenger, brought a lawsuit against Amerimex, Sandridge, and the driver. Sandridge was dismissed from the lawsuit on the grounds that Sandridge did not have any control over the transportation arrangement. Amerimex sought summary judgment by arguing that the exclusive remedy provision of Texas workers' compensation law applied, and this was denied. Next, Amerimex sought summary judgment on the grounds that Amerimex did not have any control over the transportation, and this summary judgment request was granted. Ultimately, on appeal to the Supreme Court, the court ruled that Amerimex did have sufficient control over the transportation arrangement to create liability.

The problems with this holding are very straightforward, and they apply to subcontractors just as easily as they apply to general contractors. First, workers' compensation did not offer any protection to the contractor. Second, the owner—which mandated that a driver be paid to drive other employees to work—was not liable. Consequently, the only company that could be liable in this situation was the contractor. And, a contractor's commercial general liability policy is not going to cover an accident like this. Further, the situation is something that could arise on a lot of different projects. For instance, in a high-rise development project in a crowded downtown area, an owner/developer may not want heavy traffic to a jobsite. So, that owner might mandate a carpooling arrangement in a contract. That requirement would then likely be flowed down to subcontractors. And, based on Painter, a subcontractor could be on the hook for any accidents that occur as a result of that carpooling arrangement. Adding

insult to injury, there is a good chance that the subcontractor would not have coverage for the accident.

This case deviates from a long-standing rule that is applicable in many jurisdictions: the coming and going rule. Under this tort law rule, an employee is not within the course and scope of his or her employment when that employee is coming to or going from work. This is a straightforward rule that is easy to apply and understand. In fact, this rule applies under Texas law even when an employee is paid a general travel allowance. Despite this, the Supreme Court borrowed from Workers' Compensation law and determined that, because a specific employee was contractually identified as a driver and because the $50 per day payment was a "bonus" rather than a "travel allowance," the driver was acting within the course and scope of his employment when he was driving Amerimex's employees home.

After the court's decision, Amerimex filed a Motion for Rehearing and ASA filed an *amicus*, or "friend-of-the-court," brief in support of this motion. In the amicus, ASA argued that the Supreme Court: improperly relied on workers' compensation cases to support its holding; should have focused on the task the driver was completing rather than whether the driver was generally employed by Amerimex; and the holding went against public policy.

First, ASA argued that the Supreme Court improperly relied on workers' compensation insurance caselaw to support the court's holding. ASA noted that workers' compensation protection is designed to provide compensation to injured employees and it is consequently interpreted very broadly. This broad interpretation is counterbalanced by the fact that workers' compensation insurance provides an exclusive remedy to an injured employee. Conversely, the coming and going rule provides an express limitation to the otherwise expansive realm of tort liability. The two goals are in conflict, and thus the court should not have relied on workers' compensation law to alter a common law restriction on tort liability. This is especially true because workers' compensation was found to not apply to the accident in question.

Second, ASA argued that the court improperly focused on the driver's role as an employee of Amerimex when the court should have instead focused on the driver's task at the time of the injury. In so doing, ASA pointed out the multitude of cases noting that the focus of the analysis should be on what was going on at the time of the accident. If the employee was traveling to or from work, the employee's task had nothing to do with work. ASA argued that the court's holding—which was in essence that once a person was an employee for one purpose it was an employee for all purposes—was too broad and that it overturned decades of caselaw.

Third, ASA pointed out the public policy issues with the court's holding. Specifically, ASA pointed out that the holding would disincentivize contractors and subcontractors from engaging in carpooling. Additionally, ASA argued that the holding creates the potential for coverage gaps in the construction industry. For instance, in this case, workers' compensation insurance provided no protection. And, the owner was not liable. Therefore, the contractor was left directly exposed. Finally, ASA argued that the court's ruling would turn a straightforward rule (that if an employee was going to work or leaving work, the employee's driving did not create vicarious liability) and turn it into a convoluted analysis. For instance, under the court's ruling, a contractor that specifically identified a type of employee that would receive the driving bonus would be potentially liable for subsequent accidents. However, if a contractor simply said that a bonus would be paid to any employee that chose to offer carpooling, there likely would not be liability. This, in essence, is a distinction without a difference, and it would make the standard the court arrived at unworkable because it would depend on arbitrary distinctions like whether an employee's job title was specifically identified or not.

Motions for reconsideration are always a long shot. But, at present, the Supreme Court is down to only four remaining live motions for reconsideration. All other motions that were filed during the current session have been denied. Out of these four, Amerimex's motion is still a live motion. Consequently, there is a fair chance that the Supreme Court will reconsider its decision.

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FEATURE

The Surprising Case of a Preliminary Notice That Wasn't

by R. Russell O'Rourke, Esq., Meyers, Roman, Friedberg & Lewis, LPA

Can you serve a preliminary notice too early? In Ohio there is an unfortunate court of appeals case that says YES! The case that misinterprets the Ohio statutory law and truly harms subcontractors and suppliers is the 2010 12th District Court of Appeals case for Warren County, *Halsey, Inc. v. Isbel*. The ASA Subcontractors Legal Defense Fund did not have an opportunity to write an *amicus*, or "friend-of-the-court," brief in this case.

Halsey has been largely ignored by the courts until last year when the trial court in *Pursuit Commercial Door Solutions, Inc. v. Moosally Construction, Inc.*, applied Halsey to deprive a subcontractor of its lien rights for serving its preliminary notice prior to the first date of its work on the project.

The Notice of Furnishing ("NOF") as it is called in Ohio and many states, preliminary notice in some others, are basically all the same—a subcontractor or supplier provides notice that they are supplying labor and/or materials for the project to the project owner and perhaps the prime contractor. The point: to assure that there are no "secret" mechanic's liens, those liens where the owner or the contractor was unaware of the existence of the lien claimant prior to the filing of the lien. Had they been given notice, perhaps the owner and/or the contractor could have assured that they were paid on time.

On what date in the process are you required to "give" this notice? That depends on your state statute. Ohio's statute, Ohio Revised Code §1311.05(A) is specific, "… at any time after the recording of the notice of commencement ["NOC"] … but within twenty-one days after performing the first labor or work or furnishing the first materials …" The Notice of Commencement is to be filed, "Prior to the performance of any labor or work or the furnishing of any materials for an improvement on real property which may give rise to a mechanics' lien …" ORC §1311.04(A)(1).

Generally, the NOC is filed on or about the first day of work on the project. So it is very clear, once the project is underway and the owner and the contractor should be paying attention to the project and related paperwork the sub or supplier can serve its NOF, but if it wants full lien rights it MUST serve it within 21 days of its first performance of work or supply of materials to the project site. Subject to some exceptions, a late NOF will reduce the possible lien claim by the labor performed or materials supplied on those days prior to 21 days before the NOF was served.

The point is to assure that the owner and the contractor are aware of your presence on the project so they can take steps to assure that you are paid and that they receive appropriate lien waivers to protect themselves against liens.

The construction project in *Halsey* was a single family residential project for the homeowner. No NOFs are permitted in this type of project in Ohio, but specific homeowner protection section of the Ohio Mechanic's Lien statute apply. Nonetheless, the overzealous Halsey served an NOF.

ORC §1311.011(5) provides that if the homeowner's lender pays the contractor based on the contractor's affidavit that he or she has paid all subs and suppliers in full that in the absence of "gross negligence" the lender is insulated from liability and an after-filed mechanic's lien will be void. The statute provides one specific exception being, "After receipt of a written notice of a claim of a right to a mechanic's lien by a lending institution, failure of the lending institution to obtain a lien release from the subcontractor, material supplier, or laborer who serves notice of such claim is prima-facie evidence of gross negligence." Halsey did not make such a written notice of claim, but having served its NOF, tried to rely on the NOF as that notice.

The *Halsey* court actually expanded the definition of gross negligence by holding at ¶17 that, "Since Halsey did not perfect a valid notice of furnishing, it cannot assert a prima-facie case for gross negligence under R.C. 1311.011(B)(5)." Meaning, if you dissect that sentence, that if Halsey had properly served (which it did) its NOF then it made its prima facie case that the lender was grossly negligent leaving it to the lender to defend to prove otherwise or be liable to Halsey.

While the court did that, it found that the NOF could be served too early giving the lender a pass on liability due to gross negligence. The facts of *Halsey* are that Halsey mailed its NOF on May 14 then first furnished its material on May 15. The lender received its copy on May 17 (it is unusual as in Ohio the lender is not one of the parties to be served with an NOF). Pursuant to ORC §1311.19(B) service of the NOF is considered complete upon mailing by certified mail, making the service one day before the first delivery of the materials—although you now know that such "early" service is anticipated by ORC §1311.05(A).

If the *Halsey* court's goal was to protect the lender, all it needed to do was to determine that an NOF does not substitute for a written notice of claim. Instead, even though there was no NOF required or permitted on the subject project at ¶12 the court quoted ORC 1311.05(A), but eliminated several vital words. Specifically, it looked at the words that a NOF must be served, "… within twenty-one days after performing the first labor or work or furnishing the first materials …" However, it ignored the first half of the sentence that provides for the earliest, rather than the latest time an NOF could be served, "… at any time after the recording of the notice of commencement …"

As an aside, to make the legislative intent even more clear, the statute

provides an NOF form that is satisfactory to use which concludes by stating, "The labor, work, or materials were performed or furnished first or will be performed or furnished first on _____ (date)." Clearly, the words "or will be" anticipate that the NOF can be served before the first date that the sub or supplier was on the project. Also, what is the point of finding that a *notice* was served too early? The point of the notice is to, well, give notice to someone that something is about to happen. Because the NOC has already been filed, the owner and the contractor should already be looking out for NOFs to arrive so they should be prepared to receive and process them properly to protect themselves.

Making the decision even worse, the court did not give any weight to ORC §1311.22, which provides that the Ohio Mechanic's Lien law is "to be construed liberally to secure the beneficial results, intents, and purposes thereof; and a substantial compliance with those sections is sufficient … to give jurisdiction to the court to enforce the same."

The *Pursuit* case is strikingly similar to Halsey, except that it was a commercial project. The trial court relied on *Halsey* also making the same mistake of missing the beginning of the statutory provision letting the subcontractor served its NOF at any time after the filing of the NOC.

The *Pursuit* court has the opportunity to fix an improper decision and protect subcontractors from the harm caused by the Halsey case. Where the whole point of the "notice" is to give notice in time for the owner or the contractor to act to protect themselves of the possibility of having to pay twice, you have to ask, "what is the harm suffered if the owner was served a few days early?"

Check with your construction lawyer to determine if your state has any problematic court decisions that could cause your company the same harm.

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FEATURE

Kemper Insurance Case Is Important Because It Can Be Applied Equally to Any State Which Has a Statutory Construction Trust Funds Scheme

by Jordan R. Pavlus, Esq., Byrne, Costello & Pickard, P.C.

It has long been known that a statutory system whereby construction funds are to be held in "trust" for beneficiaries is favorable to subcontractors. There are many reasons for this, but the crux behind it is that payments received by general contractors do not actually belong to them; they are trust funds to be paid to trust fund beneficiaries before they are applied for any other purpose. This can be absolutely critical when a subcontractor is seeking to enforce its right to payment. However, it can also be critical when a taxing authority is attempting to collect funds from a general contractor, but the subcontractor is also owed monies for work performed for that same general contractor on a construction project.

Perhaps this scenario sounds familiar, a general contractor is having some financial difficulties. Payments to the subcontractor start out late, then stop altogether. The subcontractor learns that the general contractor is being pursued by the Internal Revenue Service for unpaid taxes and that the IRS has issued a notice of levy to various parties who may be holding funds which are owed to the general contractor. As between the IRS and the subcontractor, who has a right to those construction funds?

The court in Kemper Insurance Companies v. State of New York, 70 A.D.3d 192 (3rd Dept. 2009) decided that precise issue. The underlying construction matter involved the reconstruction of a roadway. The general contractor posted payment and performance bonds for the project. Ultimately the State of New York declared the contractor in default and terminated it from the project. Id at 193. Thereafter, the surety agreed to complete the project in accordance with the performance bond. At the time of the termination, New York State was holding $579,779.68 which was due or to become due to the general contractor on the project.

Subsequent to the surety taking over the project, the IRS issued a notice of levy to New York State for tax obligations owed by the general contractor. Approximately seven months later, the IRS issued a second notice of levy. In response to the second notice of levy, the NYS Comptroller issued a payment of $579,779.68 to the IRS, using funds from the road reconstruction project. The Comptroller did not inquire whether the tax obligations in the notice of levy arose from the road reconstruction project. The surety was not advised of the notices of levy or payment from the NYS Comptroller to the IRS. Id at 194.

The surety completed the project and satisfied all of its obligations in accordance with the performance bond and thereafter sought payment from the State of New York. The sums paid to the surety did not include those paid to the IRS and were thus insufficient to complete the work and cover payment to the surety's laborer's, suppliers and others under the payment bond, thereby causing the surety to incur a loss.

The surety took the position that the State of New York had wrongfully diverted the contract funds and breached the takeover agreement entered into pursuant to the performance bond.

In analyzing the matter, the court noted that under the Internal Revenue Code, any person in possession of property that is subject to a federal tax levy and not subject to attachment or execution under judicial process must surrender the property to the IRS upon demand. Id at 195. Refusing to honor a levy may result in being held liable to the United States for damages and a penalty. On the other hand, a person in possession of property subject to levy who honors a federal tax levy is discharged from liability to the delinquent taxpayer and any other person. Id.

However, like many areas of the law, there are exceptions to the rule. Immunity from liability is not absolute. A person who surrenders property to the IRS which is not subject to levy is not relieved of liability to a third party who has an interest in the property. 26 C.F.R. 301.6332-1[c][2].

The surety argued that the regulatory exception to immunity applied to New York State because the general contractor had no interest in the funds when they were turned over to the IRS and because New York State failed to make a good faith inquiry.

In its analysis, the court dealt with the interplay of federal tax laws and state property rights. It noted "[f]ederal laws do not themselves create property rights; instead, they attach consequences to property rights created by state laws. For this reason, in applying federal tax laws, state law controls in determining the nature of the legal interest which the taxpayer had in the property." Id at 195-196 (internal citations and quotations omitted).

(continued on page 17)

FEATURE

American Architectural Case Has Potentially Far Reaching Implications on World of Subcontractor Payment Rights

by Jordan R. Pavlus, Esq., Byrne, Costello & Pickard, P.C.

Many states have a statutory scheme whereby a general contractor is required to hold construction monies it receives in "trust" for trust fund beneficiaries. In this respect, the general contractor serves as the trustee and the subcontractor serves as the trust fund beneficiary. This is a critical component of subcontractor payment rights because it requires that the general contractor pay those construction trust funds to trust fund beneficiaries first, before they are used for any other purpose.

Article 3A of the New York Lien Law requires that general contractors keep construction trust funds for payment to trust fund beneficiaries first, and provides that a diversion of construction trust funds for any other purpose constitutes a larceny under the New York Penal Law. Depending on the amount diverted, this could result in a felony criminal charge. Furthermore, case law has held that individual officers and owners are personally liable for the diversion of trust funds, and that punitive damages may be imposed as well.

But one case went even further to advance subcontractor payment rights based upon principles of trusteeship. In the matter of American Architectural, Inc., et al v. Marino, et al, 109 A.D.3d 773 (3rd Dept. 2013), the Third Department Appellate Division (there are four Appellate Divisions in New York State) had occasion to determine whether a detailed dispute resolution procedure was enforceable based upon the general contractor's fiduciary duties as a trustee of construction trust funds.

The subject dispute resolution clause set forth various conditions precedent to the making of any "claim, dispute or question arising out of or in relation to [the] subcontract." Id at 774. Those conditions included a seven-day time period within which a claim must be made. The subcontractor's failure to follow any of the conditions precedent resulted in a complete waiver of any claims for payment the subcontractor may have had against the general contractor.

The subcontract further provided that the general contractor was the "sole arbiter of all claims, disputes, and questions of any nature whatsoever arising out of …the [subcontract]." Id.

The subcontractor filed a mechanic's lien on the property and sought to recover approximately $1 million in claims against the general contractor and its surety. The general contractor and the surety sought to have several causes of action dismissed based upon the dispute resolution procedure and conditions precedent in the subcontract.

In response to the motion to dismiss its mechanic's lien causes of action, the subcontractor argued that the "sole arbiter" provision was void as against public policy because it violated the principles of trusteeship that the general contractor owed to the subcontractor. The court agreed, holding that "the provision in the subcontract which granted the contractor the right to act as sole arbiter violates the principles of trusteeship as reflected in the Lien Law by creating an inherent conflict of interest between [general contractor's] duty to the trust beneficiaries and its own self interest, and is unenforceable as an impediment to plaintiff's right to bring an action under article 3-A of the Lien Law." Id at 775. The court further cited section 34 of the New York Lien Law which prohibits prospective waiver of lien rights.

In making the foregoing conclusion, the court upheld the denial of those branches of the motion to dismiss filed by the general contractor and surety based upon the conditions precedent in the subcontract.

The American Architectural case has potentially far reaching implications on the world of subcontractor payment rights. Not only was it based on express statutory duties imposed on general contractors as trustees of construction funds, but it went even further and relied on common law principles of trusteeship to invalidate a dispute resolution mechanism which created an inherent conflict of interest for the general contractor. To wit: when the general contractor is both the trustee of construction funds and the sole arbiter of claims, it violates its fiduciary duty to the trust fund beneficiaries (subcontractors) because it is in its own self interest to deny those claims.

Inasmuch as many states have a statutory system which provides that general contractors are trustees of construction funds for the benefit of subcontractors, American Architectural may be used as persuasive authority to argue that dispute resolution provisions which violate the duties of trusteeship are void and unenforceable. This may allow a subcontractor to keep its claims alive when they would otherwise be subject to dismissal for failure to meet contractual conditions precedent.

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FEATURE

DRAs and DRBs: An Effective Way to Resolve Disputes

by Donald Gregory, Esq., Kegler, Brown, Hill and Ritter

As the construction industry has struggled to resolve disputes in a timely and cost-effective manner we have seen the rise of DRAs (Dispute Review Advisors) and DRBs (Dispute Review Boards) in an effort to resolve disputes "out in the field" in real time. Often a single DRA will be used on more modest sized projects, while a three-person (panel) DRB will be used on larger or more complex projects.

Both DRAs and DRBs have been used with increasing frequency across the construction industry. These boards typically include independent experts whose job it is to oversee project events, and employ expertise and impartial judgment to make recommendations to parties about disputes on a construction project. While not legally bound, the parties frequently adopt the recommendations of the DRA or DRB.

The goal of DRBs is to settle disputes at the earliest opportunity at the lowest project level possible. The hope is that by resolving disputes quickly and informally disputes will cause minimal disruption in the project and long-term relationships will be protected, while legal fees and disruptions are minimized. Real-time dispute resolution mechanisms like DRAs and DRBs have been very effective at achieving cost-effective outcomes without formal "lawyering up."

Some of the advantages of the DRB process are:

- Parties are less likely to advance frivolous claims or defenses at the risk of losing credibility with the DRB.
- Board members continually monitor the project and readily understand developments.
- Board members get to know and understand the people involved and can facilitate trust and respect.

Ongoing knowledge of the project and its participants gives credibility and support to the DRB's recommendation.

The Ohio Department of Transportation has frequently used ADR processes such as DRAs and DRBs, and has done so since 2002. This is one of the reasons that ODOT has experienced much less litigation in the Court of Claims than other similarly situated state agencies doing a similar volume of construction work.

Studies have shown that DRBs have been positively received by project stakeholders and contribute to the success of a project. Resolution rates (avoiding litigation) of almost 99 percent have been reported.

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Kemper Case, cont'd.

Turning to New York State property rights, the court noted that all funds under the roadway reconstruction project were subject to a statutory trust imposed by Article 3A of the Lien Law, which arose automatically upon execution of the contract. The trust res consists of not only funds received, but also the right to receive funds in the future, including prospective payments contingent on future performance. Id at 196.

Based upon those state property rights, the court held that because the general contractor had no apparent interest in the construction trust funds at the time when the funds were turned over to the IRS, New York State was liable for diverting those construction trust funds to the IRS.

Kemper Insurance is an important case because it can be applied equally to any state which has a statutory construction trust funds scheme. If the IRS issues a notice of levy for a general contractor and construction trust funds are paid to the IRS, instead of trust fund beneficiary subcontractors, the party who sent those funds to the IRS could be liable for a diversion of trust funds. Furthermore, a direct action may be brought against the IRS in federal district court to recover project funds (see 26 USC 7426).

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FEATURE

Don't Go to Court to Find Out If Your Arbitration Clause Is Enforceable

by R. Russell O'Rourke, Esq., Meyers, Roman, Friedberg & Lewis, LPA

Two new cases that may change the way you write your contracts were decided by the U.S. Supreme Court in the first 15 days of 2019. The issue in both cases is "arbitrability," meaning whether the terms of your contract bind you to arbitration. While both cases dissect and closely follow the language the Federal Arbitration Act the first case, Henry Schein, Inc. v. Archer & White Sales, Inc., decided on Jan. 8, 2019, is the most important consideration for drafting/reviewing your construction contracts. The second case, *New Prime, Inc. v. Oliveira*, decided Jan. 15, 2019, deals with "contracts for employment" in the case where the individual was engaged as an independent contractor—if you hire individuals as subcontractors, this may have an effect on your company, too.

Starting with *Schein*, the court in a unanimous decision, upheld the terms of an arbitration clause that indirectly, but specifically enough, delegates to an arbitrator, not a court, the exclusive right to determine whether the case is arbitrable. Schein argued that by incorporating the Rules of the American Arbitration Association meant that all of the rules were incorporated, including (construction rule for our purposes) R 9 Jurisdiction which provides at subsection (a) "The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement." The court confirmed earlier decisions and over-ruled differing decisions from several federal circuit courts and a California Court of Appeals.

In *Schein*, a dispute arose between the parties, then Archer & White filed suit in Federal District Court in Texas alleging violations of federal and state antitrust law, seeking both money damages and injunctive relief (to stop from doing what they were doing). Schein defended citing the Disputes clause contract which provided:

Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of [Schein]), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina."

Archer argued that the fact that because they had included a claim for injunctive relief the dispute was not subject to arbitration and that any attempt to enforce the arbitration provision would be "wholly groundless," following the fifth and other Circuit Courts. Justices Sotomayer, Breyer, Alito, Roberts, and Gorsuch took Archer's attorney to task on that issue with Justice Gorsuch concluding for the bench that, "the whole point of arbitration … is to … streamline things and having litigation all the way up and down the federal system over "wholly groundless," only to end up in arbitration, ultimately seems highly inefficient."

The court unanimously agreed that, "We must interpret the Act as written, and the Act in turn requires that we interpret the contract as written. When the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract" and that the "… wholly groundless exception … is inconsistent with the statutory text [of the Act] and with our precedent." "The Act does not contain a 'wholly groundless' exception, and we are not at liberty to rewrite the statute passed by Congress and signed by the President." The court was not saying that they believed that the case was arbitrable, only that the duty to make that determination was the job of an arbitrator, "After all, an arbitrator might hold a different view of the arbitrability issue than a court does, even if the court finds the answer obvious."

What You Should Do

If you believe that deciding disputes in private through arbitration with an experienced arbitrator is more beneficial to you than trying your case in public and perhaps before a jury that is unlikely to understand much of the nuance of construction contracts and be totally lost by experts' opinions about concepts understood by most in the construction industry, such as the tinsel strength of structural steel, the slump of concrete or the necessity of an admix, you need to assure that your

contract contains a powerful arbitration clause that "clearly" and "unmistakably" requires arbitration and just as clearly and unmistakably gives the power to determine whether the case is arbitrable to the arbitrator, otherwise a court will be making that decision (read you'll spend a ton on legal fees to find out—Schein had to go all the way to the U.S. Supreme Court). The court agreed that Schein, by merely incorporating the AAA rules which contain that specific language to empower the arbitrator to decide, was sufficient. Check with your own construction attorney, however, to be safe, you should include the specific clause—take if from the AAA rule if you want—that grants the power to the arbitrator, taking it away from the court. If your arbitration clause is not clear and/or your delegation clause is not clear the default will be to have these issues determined by the court.

The *New Prime* case deals with New Prime, an interstate trucking company and Oliveira, one of its truckers. Oliveira signed an independent contractor agreement that contained a mandatory arbitration provision. Oliveira filed a class-action lawsuit claiming that New Prime failed to pay its truckers lawful wages.

In the wake of the *Schein* decision, you might think that this case would be a similar slam dunk in favor of arbitration, not so. The New Prime decision was another unanimous decision, however, this time in favor of Oliveira finding that the contractual obligation to have all disputes decided through arbitration was in violation of the Federal Arbitration Act, as the does not apply to "contracts for employment."

While the contract required arbitration and it would seem that the same rule that would make the decision of arbitrability the province of an arbitrator should apply, the court found that there was a threshold test to meet and, failing that test, the case did not fit within the parameters of the Act, therefore there was nothing for the arbitrator to consider.

New Prime argued that Oliveira was not an employee, so there was no contract for employment. In the case syllabus the court noted:

New Prime's argument that early 20th-century courts sometimes used the phrase "contracts of employment" to describe what are recognized today as agreements between employers and employees does nothing to negate the possibility that the term also embraced agreements by independent contractors to perform work.

In *New Prime*, the court focuses on the single individual as the independent contractor, so while every subcontractor is an independent contractor, the court has not gone as far as applying it to true subcontractors, merely stretching the concept of "contract for employment" to include not only actual employees, but also individuals for hire as independent contractors.

On a related note, while many companies use individuals who they identify as independent contractors, they are often at risk in doing so. This is true not only because the U.S. Supreme Court has now held that you must treat these individuals the same as your employees within the terms of your contracts with them, but also for employment and tax reasons. These reasons are more detrimental and fiscally dangerous reasons as these "independent contractors" could be classified as employees and, if injured, will be covered under your state's workers' compensation laws, however, as you didn't consider them as employees, they are not covered by your "policy" making you a non-complying employer, subject to pay all of the workers' compensation benefits. There are also issues of various taxes including liability for the failure to withhold and pay taxes for income and FICA (now, both halves if you didn't withhold it from them). Please review the IRS Employee vs. Independent Contractor Checklist along with your construction/employment attorney, so you can make the proper, informed decisions.

R. Russell O'Rourke, Esq., is a partner with Meyers, Roman, Friedberg & Lewis, LPA, Cleveland, Ohio, where he serves as chair of the Construction Group. As legal counsel for The Builders Exchange and Home Builders Association, O'Rourke's 30-plus years of active involvement in construction industry trade associations—understanding both the requirements of the law and the business savvy to successfully operate within the industry—have allowed him to serve in the roles of client and industry advisor, advocate and leader. His active engagement has also translated into driving and contributing to legislative issues for the benefit of the construction industry, recognizing the issues that are most important to his clients and advising them of various approaches and resolution options using good business judgment. O'Rourke represents contractors, subcontractors, suppliers, homebuilders and remodelers throughout all stages of the process—"cradle to grave"—bidding, contract negotiation, change orders, claims and claims avoidance, mechanics' liens, bond claims and dispute resolution. He can be reached at (216) 831-0042, Ext. 153, or rorourke@meyersroman.com.

FEATURE

ASA Urges Ohio Supreme Court to Affirm Appeals Court Decision in CGL Insurance Case and 'Reverse' Earlier Court Ruling That Was 'Wrongly Decided'

by American Subcontractors Association

ASA, Associated General Contractors of Ohio, and Ohio Contractors Association asked the Supreme Court of Ohio to affirm an appeals court decision in a commercial general liability (CGL) insurance case that otherwise could have tremendous negative ramifications for subcontractors in Ohio and beyond.

In an *amicus*, or "friend-of-the-court," brief filed in *Ohio Northern University v. Charles Construction Services, Inc.*, and The Cincinnati Insurance Company, ASA, AGC of Ohio and OCA emphasized that "their members have an interest in seeing that the language in commercial general liability policies be given its plain and ordinary meaning, without resorting to the use of judicial interpretation in attempts to alter that plain meaning." "It is the custom and practice in the construction industry to rely upon the coverage provided by the plain language of commercial general liability policies for defective workmanship by a subcontractor," the amici curiae said.

In the underlying case, Ohio Northern University contracted in 2008 with Charles Construction Services to build a new luxury hotel and conference center on the ONU campus, and most of the project construction work was performed by subcontractors to Charles Construction. In 2011, after construction was complete, ONU discovered evidence of water intrusion and moisture damage to numerous areas of the building. While remediating the problems, ONU discovered serious structural defects which greatly broadened the scope of the remedial work and required completely removing and replacing the brick and masonry façade. ONU sued Charles Construction, who brought in many of its subcontractors.

Charles Construction's CGL carrier, The Cincinnati Insurance Company, moved for Summary Judgment, citing an earlier case, *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, arguing that Charles Construction's CGL policy did not provide coverage with respect to any of the damages or claims, and therefore owed no duty to defend and indemnify Charles Construction against ONU's claims. Cincinnati Insurance grounded its arguments in the Supreme Court of Ohio's proclamation in *Custom Agri* that "claims of defective construction or workmanship brought by a property owner are not claims for 'property damage' caused by an 'occurrence' under a commercial general liability policy."

ONU and Charles Construction countered that *Custom Agri* was not as broad as Cincinnati Insurance claimed and was distinguishable because the "products-completed operations hazard" portion of Charles Construction's CGL policy applied and that while the "your work" exclusion would exclude coverage for occurrence damages arising out of work performed by Charles Construction, the "subcontractor exception" to the "your work" exclusion would bring the damages in this case within the scope of coverage, as the damages were due to the allegedly defective work of subcontractors of the primary insured.

The trial court agreed with Cincinnati Insurance, finding that *Custom Agri* specifically applied and not only was there no coverage, the insurer did not even have a duty to defend the claim, because defective construction was not an occurrence under a CGL policy. ONU, claiming the benefits of coverage as an additional insured, and Charles Construction appealed, and the Hancock County Court of Appeals, Third Appellate District, reversed. The appeals court explicitly rejected Cincinnati Insurance's position that *Custom Agri* established that "all property damage" regardless of who performed it can as a matter of law never constitute an "occurrence." Further, the appeals court noted that its decision was consistent with the trend of many other jurisdictions—many of which involved cases in states where ASA has filed "friend-of-the-court" briefs—in addressing disputes with the same question.

In the brief, the amici curiae, arguing that *Custom Agri* should be overruled, told the Ohio high court, "The [*Custom Agri*] decision was wrongly decided, defies practical workability, and no undue hardship would occur from abandoning the precedent," adding, "Ultimately, the *Custom Agri* holding is inconsistent with the law of other states considering identical policies, and it is inconsistent with Ohio law, as the general holding renders superfluous existing coverage in the CGL policy." The amici curiae concluded, "The primary argument relied upon by [Cincinnati Insurance] is the broad holding in *Custom Agri*. However … *Custom Agri* was not fully briefed by adverse parties. A full review of the law interpreting this universal CGL policy shows that *Custom Agri* was wrongly decided. It also defies practical workability because it is in opposition to the law of numerous other states, and ultimately, would not work a hardship if it were reversed. …The holding in *Custom Agri* should be completely reversed."

Terry W. Posey Jr. of Thompson Hine, LLP, Miamisburg, Ohio, prepared the brief for ASA, AGC of Ohio, and OCA. ASA's Subcontractors Legal Defense Fund financed the brief. Contributions to the SLDF may be made online.

ASA/FASA Calendar

Attorney Adam Harrison to Discuss Best—and Worst—Construction Legal Decisions of 2018

by American Subcontractors Association

The Feb. 12, 2019, ASA webinar, will highlight the best and worst construction legal decisions of 2018. In "The Best—and Worst—Construction Legal Decisions of 2018," attorney Adam Harrison, president, Harrison Law Group, will share his insights and practical legal experience, providing participants with an understanding of the short- and long-term effects of these decisions and what they mean for you.

Harrison has over 25 years of experience providing counseling and legal representation to construction industry professionals at all levels of the building process. He possesses a unique and comprehensive understanding of the trends and legal issues that affect the construction industry on a daily basis.

This webinar will take place from noon to 1:30 p.m. EST. Registration is complimentary for ASA members and $179 for nonmembers. Register online.

February 2019

12 — Webinar: "The Best—and Worst—Construction Legal Decisions of 2018" presented by Adam Harrison, Harrison Law Group

March 2019

6–9 — SUBExcel 2019, Nashville, Tenn.

19 — Webinar: "Lean Construction—What Subcontractors Need to Know" presented by Lean Construction Institute

April 2019

9 – Webinar: "Avoiding Predatory OCIPs, CCIPs and Builders Risk Insurance Flow-Downs" presented by Jonathan Mitz, Ennis Elecric

May 2019

14 — Webinar: Corporate and Individual Tax Planning Under the New Tax Law, by Thomas B. Bailey, CPA, CVA, Councilor, Buchanan & Mitchell, P.C.

June 2019

11 – Webinar: **"**A Small Business' Guide to Human Resources**"** presented by Jamie Hasty, SESCO Management Consultants

July 2019

9 – Webinar: **"**Emerging Technologies—Smart Tools, UAVs and Others—and How They Relate to the Internet of Things" presented by Maxim Consulting Group

August 2019

13 – Webinar: **"Trade Shortage"** presented by Michael Brewer, The Brewer Companies

Coming Up

in the February 2019 Issue of ASA's

THE CONTRACTOR'S Compass

Theme:

Lean Construction

- Lean Construction
- ConsensusDocs Lean Addendum
- Business Development Strategies
- Legally Speaking: Cyber Attack and the Cost of Remediation

Look for your issue in February.

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