



# Construction Law Section Newsletter

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## Colorado Housing Reform: A Foreshadowing of Things to Come in New Jersey?

*by Elizabeth Ahlstrand and Gary Strong*

Colorado has a housing problem. As the state's cities grow in popularity and population, single families and young couples alike are finding it more and more difficult to obtain affordable housing. Denver is one of the nation's fastest-growing cities. It is also one of the most difficult locations for young people to find a home.<sup>1</sup> In fact, the cost of an average home in Denver rose 25 percent between 2013 and 2015, and rents have soared.<sup>2</sup> This is bad news for the millennials who have been flocking to Colorado saddled with student debt, and are increasingly unable to afford the skyrocketing prices of starter homes.<sup>3</sup> It is estimated that recent college grads hoping to buy in Denver require an average of 11.8 years to save a 20 percent down payment, compared to the national average of 5.3 years for grads settling elsewhere.<sup>4</sup> Baby-boomers are likewise finding themselves disadvantaged, forced to sell homes they lived in for years as property taxes double and triple in former middle-class neighborhoods that have become increasingly gentrified.<sup>5</sup> Sound familiar?

New Jersey, like Colorado, also suffers from housing issues, albeit of a different sort. The New Jersey real estate market has been slow to recover from the combined effects of the housing bubble collapse and Superstorm Sandy. As a result, home values remain lower, sometimes significantly so, than before the housing collapse.<sup>6</sup> However, experts believe improvement is on the horizon.<sup>7</sup> Job creation in New Jersey during 2015 was greater than any year since 1999, replacing all of the private-sector positions lost in the 2007-2009 crash.<sup>8</sup> As New Jersey's economy strengthens, millennials are seeking to build, buy and renovate homes, but legislation like the New Home Warranty and Builders' Registration Act (NHWA) and the Consumer Fraud Act (CFA) deter builders from embarking on new projects. Builders are aware that homeowners associations (HOAs) and buyers are familiar with New Jersey construction defect laws, and the threat of having to pay treble damages and attorneys' fees if anything goes wrong is formidable to say the least.

Lack of development of different types of housing in Colorado, such as condominiums, could be contributing to Colorado's problem. Condominiums are often priced lower than freestanding homes, providing a viable alternative for those with modest budgets. Colorado legislators are increasingly blaming the state's homeowner-friendly construction defect laws for the "largely non-existent affordable-condominium market."<sup>9</sup>

The source of these laws in Colorado is tri-fold, primarily a result of the combined effects of the Homeowner Protection Act (HPA), the Construction Defect Action Reform Act (CDARA) and the Colorado Consumer Protection Act (CCPA). The CDARA and CCPA both grant property owners' certain rights in construction defect cases, such as the right to recover treble damages and attorneys' fees, enforce implied warranties and bring tort claims against developers.<sup>10</sup> In addition, the HPA provides that in contracts between property owners and builders, any provision that attempts to limit a property owner's rights under the CDARA and/or CCPA is void and unenforceable.

The financial impact of these laws on developers, owners and contractors is profound, with one report estimating that construction defect litigation is 12 times more expensive for condominium developers than developers of other types of housing, adding "about \$15,000 per unit to the cost of building condos."<sup>11</sup> As a result, in recent years condo contractors and developers have been extremely hesitant to commit to new projects.<sup>12</sup> In an effort to reinvigorate development, Colorado legislators have been attempting to pass bills that would make it more difficult for homeowners and HOAs to sue builders.

The latest proposed bill, Senate Bill 213, included provisions that would prevent HOAs from eliminating mediation or arbitration agreements from declaration documents and require a majority of condominium unit owners to approve any legal action.<sup>13</sup>

To date, these efforts at reform have been unsuccessful, generally losing momentum after the Senate vote and ultimately dying before reaching the House of Representatives. Impatient for change, some municipalities have taken matters into their own hands. So far, 14 cities, including Denver, have passed local reform measures aimed at encouraging condominium developers to begin new projects.<sup>14</sup>

In Denver, such measures include requiring that HOAs obtain written consent from a majority of unit owners before the board is able to sue a developer, limit-

ing the circumstances under which a developer's failure to substantially comply with building codes gives rise to a private cause of action and requiring the consent of the developer before HOAs are able to alter the language of an arbitration clause.<sup>15</sup> Whether these local laws will survive judicial scrutiny remains to be seen. In the meantime, reformers have vowed to push the cause until the state laws are revised to benefit homeowners and builders alike.

Similar to Colorado's laws, New Jersey law disproportionately favors homeowners' rights over builders. Indeed, the CFA<sup>16</sup> and NHWA<sup>17</sup> impose some of the strictest construction regulations in the country on builders, owners and developers. Under the NHWA, all aspects of construction up to the first two years after a home is built are warrantied, and major structural elements are warrantied for an additional eight years.<sup>18</sup> The NHWA further requires new-home builders to register with the state before beginning construction.<sup>19</sup> New Jersey's exceedingly broad CFA,<sup>20</sup> gives anyone a private cause of action who suffers ascertainable loss of property as a result of another's unconscionable commercial practice, including, but not limited to, deception, fraud, and concealment of omission. New Jersey also generously allows plaintiffs who prevail on a CFA claim to recover damages as well as attorneys' fees.

Fortunately for builders in New Jersey, a recent decision by the New Jersey Supreme Court demonstrates that change may be on the horizon. In *Perez v. Professionally Green, LLC*, the New Jersey Supreme Court held that the CFA's "ascertainable loss" requirement only entitled homeowners to attorneys' fees if the CFA violation was the actual cause of damage to the home.<sup>21</sup> Before *Perez*, various lower courts reached the opposite conclusion and permitted homeowners to recover attorneys' fees on a technical violation unrelated to the home damage, thereby ensuring the deck was stacked against builders.<sup>22</sup> The *Perez* Court's interpretation of the CFA levels the playing field for builders while maintaining adequate protection for consumers.

Perhaps New Jersey legislatures will follow suit, begin to re-think the impact the state's construction defect laws appear to be having on the housing market and pursue what the author believes are sensible reforms that benefit both homeowners and the construction industry. As New Jersey's housing market recovers, builders will want swift assurance that their rights are adequately protected. The author believes the sooner the better, since Colorado's story indicates that change will be slow, in more ways than one.

Lakewood, Colorado, was the first city in Colorado to pass reform measures in 2014, giving developers a chance to repair defects before facing litigation, and requiring a majority of every unit-owner in a condominium complex to approve any prospective suit.<sup>23</sup> Despite these measures, not one new condominium development has been initiated in Lakewood in the past two years. The author believes such stagnation is detrimental to builders and prospective homebuyers alike, and no one wants to see New Jersey facing a similar predicament as the market continues to recover and demand for housing increases. ■

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# Supreme Court Affirms Coverage for Construction Defects

by Robert D. Chesler and Bruce Strong

The New Jersey Supreme Court has affirmed the Appellate Division's pro-policyholder decision in *Cypress Point Condominium Association v. Adria Towers, L.L.C.* confirming broad coverage for construction defects.<sup>1</sup> In a scholarly decision, the Supreme Court traced the development of the relevant provisions of the general liability insurance policy, examined decisions from other jurisdictions, and reviewed law review articles and dictionaries in order to find coverage for the consequential damages arising out of construction defects.

The underlying facts of this case are sadly very typical. Roof, facade, and window construction defects caused water infiltration and resulting damage to the condominium complex's interior structure, to interior window jambs and sills of the owners' units, and to common areas. The condominium association sued the developers and several subcontractors for faulty workmanship during construction, including, but not limited to, defectively built or installed roofs, gutters, brick facades, exterior insulation and finishing system siding, windows, doors, and sealants. The association claimed consequential damages, consisting of, among other things, damage to steel supports, exterior and interior sheathing and sheetrock, and insulation, and also to Cypress Point's common areas, interior structures, and residential units.<sup>2</sup>

One of the developers sued its insurance company, Evanston Insurance Company, which denied any coverage obligation, resulting in the coverage action. It is noteworthy that the association sued under four consecutive insurance policies in place during the four years of construction. Moreover, Evanston then sued another insurance company for contribution. Thus, *sub silentio*, the Supreme Court acknowledged that the continuous trigger theory of insurance coverage applied not just to toxic tort and environmental actions, but also to construction defect actions.

Evanston asserted that coverage did not exist because: 1) there was no "occurrence," which the insurance policy defined in relevant part as an accident, and 2)

no "property damage."<sup>3</sup> Evanston asserted that since there was no occurrence, the court could not reach the exclusions, and particularly the subcontractor exception to the "your work" exclusion. The trial court adopted Evanston's arguments, but the Appellate Division reversed.<sup>4</sup>

The New Jersey Supreme Court began its discussion of the law with an examination of the rules of insurance policy construction. Most importantly, the Court stressed that "if the controlling language of a policy will support two meanings, one favorable to the insurer and the other to the insured, the interpretation favoring coverage should be applied."<sup>5</sup> The Court noted that if there was an ambiguity, a court could turn to extrinsic evidence.

After a detailed review of authorities and case law from other jurisdictions, the Supreme Court first tackled the issue of property damage:

Here, the Association alleged that water infiltration, occurring after the project was completed and control was turned over to the Association, caused mold growth and other damage to Cypress Point's completed common areas and individual units. Those post-construction consequential damages resulted in loss of use of the affected areas by Cypress Point residents and, we hold, qualify as "[p]hysical injury to tangible property including all resulting loss of use of that property." Therefore, on the record before us, the consequential damages to Cypress Point were covered "property damage" under the terms of the policies.<sup>6</sup>

It is of interest that the Court concentrated on the "loss of use" aspect of property damage, and not on the issue of physical damage to tangible property.

The Court next examined whether an "occurrence" had taken place, which the policy defined, in relevant part, as an accident. The Court found the term accident "encompasses unintended and unexpected harm caused



by negligent conduct.”<sup>7</sup> The Court found the consequential property damage was not foreseeable, and that no one claimed the subcontractors intentionally caused the property damage.

Evanston argued the damage was a normal, predictable risk of doing business, relying on *Weedo v. Stone-E-Brick, Inc.*<sup>8</sup> and *Firemen’s Insurance Co. of Newark v. National Union Fire Insurance Co.*<sup>9</sup> The Court held that *Weedo* and *Firemen’s* were inapposite for two reasons—first, because both cases involved an earlier Insurance Services Office, Inc. (ISO) form of the general liability policy from 1973, and not the newer 1986 ISO policy form that was at issue, and second, because the developer in *Cypress Point* was seeking insurance coverage for consequential damages resulting from faulty workmanship instead of for the cost of replacing the faulty workmanship, as was the case in *Weedo* and *Firemen’s*.<sup>10</sup>

The 1973 form contained a “your work” exclusion that specifically excluded coverage for “property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.”<sup>11</sup> The 1986 form, however, contained a crucial exception to the “your work” exclusion, such that the exclusion would “not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.”<sup>12</sup> The Court explained that the insurance industry began selling the 1986 ISO form with the intent to “provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor...both because of the demands of the policyholder community (which wanted this sort of coverage) and the view of insurers that the CGL [policy] was a more attractive product that could be better sold if it contained this coverage.”<sup>13</sup> Accordingly, in

light of the new language in the 1986 form, and the clear intent of the insurance industry in promulgating this form to cover a subcontractor’s faulty workmanship, the Court was able to distinguish *Weedo* and *Firemen’s*.

The Court then concluded by holding that the association’s claims of consequential water damage resulting from defective workmanship performed by subcontractors constituted both an “occurrence” and “property damage” under the terms of the policies.<sup>14</sup>

Going forward, it will be interesting to see how New Jersey courts handle faulty workmanship insurance claims. *Cypress Point* held that consequential damages resulting from a subcontractor’s faulty workmanship will be covered under a developer’s CGL policy, provided the developer purchased the 1986 ISO form policy. On the other hand, the Court appears to have endorsed the holdings in *Weedo* and *Firemen’s* that the cost of replacing faulty workmanship (not necessarily the consequential damages resulting from the faulty workmanship) is excluded from coverage under the 1973 ISO form policy.

What remains to be seen is whether New Jersey courts will start to find that the cost to the developer of replacing a subcontractor’s faulty workmanship will be covered under the 1986 ISO form. ■

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## Endnotes

1. *Cypress Point Condo. Ass’n v. Adria Towers, L.L.C.*, (A-13/14-15) (076348), 2016 N.J. LEXIS 847 (Aug. 4, 2016).
2. *Id.* at \*16.
3. *Id.* at \*38.
4. *Cypress Point Condo. Ass’n, Inc. v. Adria Towers, L.L.C.*, 441 N.J. Super. 369 (App. Div. 2015).
5. *Cypress Point Condo. Ass’n*, 2016 N.J. LEXIS 847, at \*23 (citations omitted).
6. *Id.* at \*37-38.

7. *Id.* at \*40.
8. *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233 (1979).
9. *Firemen’s Ins. Co. of Newark v. Nat’l Union Fire Ins. Co.*, 387 N.J. Super. 434 (App. Div. 2006).
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11. *Id.* at \*26 n.9.
12. *Id.* at \*26.
13. *Id.* at \*26, \*45-46 (citations omitted).
14. *Id.* at \*48.

# Forum Restrictions in Condominium Governing Documents

by Steven Nudelman

In May 2015, the Colorado Court of Appeals decided that a homeowner's association could not remove a stipulation from its declaration mandating arbitration as the means of dispute resolution unless the builder/developer consents to its removal. The decision in *Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc.*<sup>1</sup> disturbed counsel for community associations since it essentially allowed a developer to require that all disputes against it—sounding in construction defect or otherwise—be resolved by arbitration in perpetuity. Thus, the unit owners were forever precluded from amending the declaration after they assumed control of the condominium association to remove this forum restriction.

By way of background, in 2007 Metro Inverness, LLC, together with its manager and general contractor, Metropolitan Homes, Inc. (MHI), formed the Vallagio at Inverness Residential Condominium Project in Englewood, Colorado. To establish the project as a condominium development under Colorado law, the developer (also known as the declarant), was required to prepare and record a formal declaration under the Colorado Common Interest Ownership Act (CCIOA).<sup>2</sup> As the declarant, Metro recorded the declaration for the project, which included a number of 'pro-developer' provisions.

Section 16.6 of the declaration mandated arbitration to resolve any construction defect claims. This section also provided that its terms, "shall not ever be amended without the written consent of declarant and without regard to whether declarant owns any portion of the real estate at the time of the amendment."<sup>3</sup> After the unit owners took control of the association, they voted to amend the declaration for the project to remove this section in its entirety (without the consent of Metro).<sup>4</sup>

Shortly thereafter, the association sued Metro, MHI and others, seeking damages for construction defects at the project. The defendants moved to compel arbitration based on Section 16.6 of the declaration. The defendants argued that the amendment was invalid because the asso-

ciation failed to obtain Metro's consent prior to promulgating it.<sup>5</sup> The district court denied the defendants' motion, finding the association did *not* require Metro's consent.<sup>6</sup> The defendants filed an interlocutory appeal.

The Colorado Court of Appeals reversed, holding that the declaration was: 1) not ambiguous and enforceable as written; and 2) not violative of the CCIOA.<sup>7</sup> As a result, the association was required to arbitrate its construction defect claims against Metro.

Noting that arbitration is favored as a "convenient and efficient alternative to resolving disputes by litigation," the Court interpreted the declaration using ordinary contract principles.<sup>8</sup> "[A]s a matter of contract interpretation, the declaration required unit owners to obtain Metro Inverness' consent before amending the declaration to remove section 16.6, including its arbitration provision."<sup>9</sup>

Since the Supreme Court of Colorado granted a petition for *certiorari* in *Vallagio* this past June, the issue in Colorado remains unsettled.<sup>10</sup>

What about New Jersey? May a developer include a *Vallagio*-like forum restriction in the master deed for a New Jersey condominium association? In New Jersey, the CCIOA is inapplicable; one must instead look at the New Jersey Condominium Act (NJCA)<sup>11</sup> and the case of *Mirmanesh v. Brasslett*.<sup>12</sup>

In *Mirmanesh*, unit owners in a five-unit condominium development had disputes among themselves regarding alleged violations of certain restrictions in the master deed. Among other things, the master deed restricted how unit owners could store and dispose of trash, and where and when they could place patio furniture and speakers on the common elements. The defendant unit owners asserted control over the board of trustees of the condominium association and voted to relax these restrictions. The plaintiffs claimed the defendants' conduct was wrongful and contrary to the master deed, which could not be amended by its terms.<sup>13</sup>

The trial court ruled in favor of the plaintiffs, finding the applicable section of the master deed could not

be enforced because it was contrary to the NJCA. The Appellate Division disagreed.

Section 11 of the NJCA provides, in pertinent part:

The master deed may be amended or supplemented in the manner set forth therein. Unless otherwise provided therein, no amendment shall change a unit unless the owner of record thereof and the holders of record of any liens thereon shall join in the execution of the amendment or execute a consent thereto with the formalities of a deed. Notwithstanding any other provision of this act or the master deed, the designation of the agent for service of process named in the master deed may be changed by an instrument executed by the association and recorded in the same office as the master deed.<sup>14</sup>

The Appellate Division found that Section 16.01 of the master deed is not contrary to this provision of the NJCA. Specifically, the Court held that “N.J.S.A. 46:8B-11 permits the master deed to be amended at any time, except when a provision ‘therein’ precludes an amendment. Here, the Master Deed specifically bars the adoption of an amendment prior to the expiration of the forty years specified in the Master Deed.”<sup>15</sup> Thus, the lower

court’s decision was reversed and the Appellate Division enforced the plain language of the master deed—much the same way the court of appeals did in *Vallagio*. Therefore, one could anticipate that New Jersey courts will likely enforce a *Vallagio*-like forum restriction the same way as enforced by the Colorado appellate court.

The important takeaways from these intermediate appellate decisions: Neither court found the applicable provision contrary to public policy. Both courts enforced the declaration/master deed according to its terms. While the Community Association Institute has warned that the *Vallagio* decision “gives developers unfettered power to immunize themselves from liability by taking away every association’s ability to remove self-serving provisions from its governing documents,” that is simply not the case.<sup>16</sup> At best, the restrictions in these governing documents limit the forum in which disputes may be heard to arbitration; they in no way immunize developers from liability for defective construction. ■

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## Endnotes

1. No. 14CA1154, 2015 Colo. App. LEXIS 693 (Colo. Ct. App. May 7, 2015).
2. Colo. Rev. Stat. § 38-33.3-101 *et seq.* (2005).
3. *Vallagio*, 2015 Colo. App. LEXIS 693, at \*3.
4. *Id.*
5. *Id.* at \*4.
6. *Id.* at \*5.
7. This article does not address the association’s arguments under the CCIOA, which were rejected by the court of appeals.
8. *Id.* at \*6.
9. *Id.* at \*11.
10. No. 15SC508, 2016 Colo. LEXIS 618 (2016). The Supreme Court summarized the issues for review as follows:

Whether the court of appeals erred by holding as a matter of first impression that [the] CCIOA permits a developer-declarant to reserve the power to veto unit owner votes to amend common interest community declarations.

Whether the court of appeals erred in holding that Colorado’s Consumer Protection Act (‘CCPA’) claims are subject to pre-dispute mandatory arbitration provisions where this Court previously held, ‘We leave open the question of whether CCPA claims might be deemed non-arbitrable,’ *Ingold v. AIMCO/Bluffs, LLC Apartments*, 159 P.3d 116, 122 n.5 (Colo. 2007).



11. N.J.S.A. 46:8B-1 to -38.
12. No. A-3433-13T3, 2015 N.J. Super. Unpub. LEXIS 1508 (App. Div. June 23, 2015). By way of full disclosure, the author's law firm represented the appellants in *Mirmanesh*, although the author had no involvement in that representation.
13. Article 16.01 of the master deed provided, in pertinent part:

The provisions of this Master Deed shall be perpetual in duration, shall run with and bind all of the land included in the Condominium and shall inure to the benefit of and be enforceable by the Association and the Unit Owners, their respective successors, assigns, heirs, executors, administrators, and personal representatives, except that *the covenants and restrictions set forth in Article XI shall have an initial term of forty years from the date this Master Deed is recorded in the Office of the Cape May County Clerk, at the end of which period such covenants and restrictions shall automatically be extended for successive periods of ten (10) years each, unless at least three-fifths (3/5) of the Unit Owners at the time of expiration of the initial period, or of any extension period, shall sign an instrument, or instruments (which may be in counterparts), in which they shall agree to change said covenants and restrictions in whole or in part;* (Emphasis added.)

14. N.J.S.A. 46:8B-11(emphasis added).
15. 2015 N.J. Super. Unpub. LEXIS 1508, at \*11.
16. Br. of *Amicus Curiae*, CAI, at 14 (supporting the petition for review of the appellate court's decision in *Vallagio* submitted to the Supreme Court of Colorado).

# Vincent Pools v. APS Contractors: Clarifying the Application of New Jersey's Offer of Judgment Rule in Multi-Defendant, Non-Tort Cases

by George E. Pallas, Kathleen M. Morley and Gary J. Repke Jr.

Those familiar with New Jersey practice are well aware that the courts of this state strongly encourage settlements as a matter of public policy because they facilitate the amicable resolution of disputes and lighten the increasing load of litigation faced by courts.<sup>1</sup> Rule 4:58-2 of the New Jersey Rules of Court, otherwise known as the offer-of-judgment rule, operates as a mechanism to encourage and promote the early, out-of-court settlement of damages claims that ought to be settled without trial, by imposing financial consequences on a party who rejects a settlement offer that turns out to be more favorable than the ultimate judgment in a case.<sup>2</sup>

Particularly, under Rule 4:58-2, when a claimant's pretrial offer is rejected, and the monetary award exceeds 120 percent of the offer, the offeror is entitled to recover its reasonable costs, prejudgment interest and reasonable attorneys' fees for subsequent services compelled by the non-acceptance.<sup>3</sup> The rule is not discretionary; rather, it strictly demands that the court award the offeror its reasonable fees and costs of suit where the elements of the rule are satisfied.<sup>4</sup>

Recently, the New Jersey Superior Court, Appellate Division, in an unpublished opinion, analyzed, for the first time, the offer-of-judgment rule in the context of multiple defendants where their liability is not joint and several. In *Vincent Pools, Inc. v. APS Contractors, Inc.*, the plaintiff sued multiple parties for contract, bond and lien claims arising from a municipal construction project. More specifically, the single plaintiff was a subcontractor and the claims and defendants included a mechanic's lien claim against the municipal owner, a breach of contract claim against the general contractor and a payment bond claim against the general contractor's surety.

Prior to the *Vincent Pools* decision, New Jersey decisions only addressed the offer-of-judgment rule in the context of multiple defendants, where the defendants were held jointly and severally liable for the underlying

wrong. In those decisions, for purposes of offers of judgment, plaintiffs were held only to have to deal in terms of the entire liability of all defendants, and not individual defendants' shares of liability, based on the fundamental purpose behind joint and several liability, which was designed to remove the burden of proving the allocation of liability between and among multiple defendants from the innocent plaintiff.

The Appellate Division in *Vincent Pools* upheld the same application of the offer-of-judgment rule in the context of multiple defendants where there is no joint and several liability alleged and the plaintiff demands one amount to settle all claims against all defendants. The Appellate Division rejected the defendants' claim that Rule 4:58-2 does not apply to a single plaintiff's offer to multiple defendants in a contract-based case.

## Decision

By way of further background, *Vincent Pools* involved the construction of a new municipal pool complex (the project), owned and operated by Jersey City. The city hired APS Contractors, Inc. to serve as the general contractor for the project. Pursuant to its contract with the city, APS obtained a labor and material payment bond from Colonial Surety Company, Inc. guaranteeing payment for work by APS's subcontractors. APS subcontracted with Vincent Pools, Inc. to perform certain plaster installation work in connection with two swimming pools located at the project.

When a problem with the condition of the plaster in one of the two pools was discovered by the city's architect, the city demanded that APS have the plaster in the pool removed and replaced. When APS failed to do so, the city terminated APS. Prior to termination, the city had paid APS for the work performed by Vincent Pools. When APS withheld payment to Vincent Pools for its unpaid work on the project, Vincent Pools submitted a claim against the payment bond and filed a municipi-

pal mechanic's lien against the project funds for the outstanding amounts.

Thereafter, Vincent Pools commenced its lawsuit against APS, Colonial and the city, asserting a breach of contract claim against APS and seeking to recover the amounts owed to it for work on the project, a payment bond claim against Colonial and a municipal lien claim against the city. APS sought cross-claims against the city for unrelated contract balances and change orders, and the city defended against liability to Vincent Pools on the basis that it had already paid APS for that work. At trial, the jury rendered a verdict in favor of Vincent Pools and, following entry of the judgment, Vincent Pools filed a petition for counsel fees pursuant to Rule 4:58-2, based on rejected offers of judgment issued to the defendants prior to the trial.

The defendants opposed the petition, arguing *inter alia* that the offer-of-judgment rule should not be applied to a single plaintiff's offer to multiple defendants in a contract, or non-tort, case. The trial court granted Vincent Pools' petition and awarded counsel fees, holding that the defendants were equally responsible for the plaintiff's reasonable attorneys' fees associated with the trial pursuant to the offer-of-judgment rule. The city, APS and Colonial appealed the Rule 4:58-2 award and, in an unpublished decision dated March 18, 2016, the Appellate Division affirmed.

The Appellate Division found that it was acceptable for the plaintiff in *Vincent Pools* to issue an offer to settle the entire liability of all defendants and to hold the defen-

dants to the financial consequences of non-acceptance when trial resulted in a more favorable judgment to the plaintiff notwithstanding the fact that the claims against the defendants did not implicate joint and several liability. The Appellate Division reasoned that acceptance of the offer by any of the individual defendants would have resolved all claims the plaintiff had against the defendants, and the defendants could have sought reimbursement and any cross-claims between themselves thereafter.

### Implication

In *Vincent Pools*, the Appellate Division has signaled that the offer-of-judgment rule, and its financial consequences under Rule 4:58-2, are applicable to a plaintiff's single offer of judgment made to multiple defendants, even where liability of one or more defendants is dependent upon the liability of another, and where no joint and several liability is alleged. Practitioners representing clients in commercial, contract and construction-related disputes should be aware of the decision in *Vincent Pools* and its potential implications regarding offers of judgment in multi-defendant cases. ■

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### Endnotes

1. *DuHamell v. Renal Care Group East, Inc.*, 431 N.J. Super. 93, 97 (Law Div. 2012).
2. *Schettino v. Roizman Dev., Inc.*, 158 N.J. 476, 482 (1999). Depending upon whether the offeror is the claimant or another party, the definition of "favorable" differs. See R. 4:58-2, -3 and -4.
3. R. 4:58-2(a).
4. *Wiese v. Dedhia*, 188 N.J. 587, 592 (2006).
5. 2015 WL 10489978/2016 N.J. Super. Unpub. LEXIS 595 (N.J. Super. Ct. App. Div., March 18, 2016).

# Subcontractors' Rights and Woes: Enforceability of Pay-if-Paid Clauses in New Jersey and New York Contracts

by Milena Shtelmakher and Mark D. Shifton

Construction contracts between general contractors and subcontractors can include a 'pay-if-paid' clause, whereby the general contractor typically renounces responsibility to pay the subcontractor until after the general contractor receives payment from the owner. On their face, such clauses may appear to unfairly place the risk of nonpayment by the owner on the subcontractor. However, in New Jersey, these clauses are enforceable if the contract contains specific language. On the other hand, New York courts have determined that such provisions are invariably against public policy.

## New Jersey: Enforceability Requires Explicit and Unambiguous Shifting of Risk

While New Jersey does not have a specific statute regulating pay-if-paid provisions, such provisions are enforced if they explicitly and unambiguously shift the risk of nonpayment from the owner to the subcontractor.<sup>1</sup> In *Fixture Specialists, Inc. v. Global Construction, LLC*, the Federal District Court of the District of New Jersey held the following provision enforceable:

Subcontractor agrees that Contractor shall never be obligated to pay Subcontractor under any circumstances, unless and until funds are in hand received by Contractor in full, less any applicable retainage, covering the Work or material for which Subcontractor has submitted an Application for Payment. This is a condition precedent to any obligation of Contractor, and shall not be construed as a time of payment clause.<sup>2</sup>

The subcontractor argued that the clause was a time of payment provision because it did not expressly state a shifting of the risk.<sup>3</sup> In rejecting the subcontractor's argument, the court reiterated the decision in *Avon Brothers,*

*Inc. v. Tom Martin Construction Company, Inc.*, wherein the Appellate Division held that "it is not the use of 'when' or 'if' that is dispositive of the enforceability of the clause, but whether there is clear evidence of an intent by both parties to shift the risk of collection," and such risk is "not [to] be assumed or inferred."<sup>4</sup> The *Fixture* court held that the use of specific phrases such as "never be obligated to pay" and "under any circumstances" clearly and unambiguously expressed that the subcontractor agreed to assume the risk of the owner's nonpayment.<sup>5</sup>

Additionally, the court rejected the subcontractor's argument that pay-if-paid clauses are against public policy because they violate New Jersey's anti-waiver statute of the Construction Lien Law.<sup>6</sup> The court cited *Thomas Group v. Wharton Senior Citizen Housing*, where the New Jersey Supreme Court reasoned that even if payment was not technically due under a contract between the parties, a contractor may still file a lien against the owner's property to protect its interest; however, foreclosure of the lien by the owner would be stayed until all the contractual preconditions to payment were satisfied.<sup>7</sup> Based on *Thomas*, the *Fixture* court held that the subcontractor had a legal remedy against the owner—to file a lien—even though the preconditions of the contract had not been met and, thus, the subject pay-if-paid clause did not violate public policy.<sup>8</sup>

Subsequently, the Appellate Division affirmed the enforceability of the following clause:

It is expressly understood and agreed that the receipt by the Contractor of payment for the Subcontractor's work shall be a condition precedent to the Contractor's obligation to pay the Subcontractor. That is, the Contractor shall have no liability or responsibility for any amounts due or claimed to be due the Subcontractor for any reason whatsoever except to the extent that

the Contractor has actually received funds from the Owner specifically designated for disbursement to the Subcontractor.<sup>9</sup>

Regardless of the validity of the above clause, the subcontractor claimed the contractor had received payment from the owner but refused to pay the subcontractor.<sup>10</sup> The contractor argued it had settled with the owner for a lump sum for all the work performed on the project, and there was no indication the owner made a payment specifically designated for the subcontractor's work.<sup>11</sup> The Appellate Division rejected the contractor's argument, holding that a general contractor could not avoid its responsibility to pay any of its subcontractors by entering into a "global" settlement with an owner that did not specifically designate payment for each particular subcontractor.<sup>12</sup>

### **New York: Unenforceable as Against Public Policy**

The subcontractor in *Fixture* cited to New York case law in support of his argument that the pay-if-paid clause in his contract was against public policy. In direct contrast to the case law in New Jersey, the New York Court of Appeals has held that pay-if-paid provisions are contrary to public policy and are void and unenforceable.<sup>13</sup> In interpreting New York's Lien Law, the New York Court of Appeals has determined that pay-if-paid provisions violate subcontractors' mechanics' lien rights in the event of nonpayment by the owner because mechanics' liens may not be enforced until a debt becomes due and payable.<sup>13</sup>

However, the New York Court of Appeals distinguished provisions that merely fix the time for payment rather than expressly make payment from the owner to the contractor a condition precedent to any payment to

the subcontractor.<sup>15</sup> Such pay-when-paid provisions are enforceable because they do not violate the public policy of the Lien Law.<sup>16</sup>

Significantly, the New York Court of Appeals has also held that New York's public policy is "not so fundamental that it should override the parties' choice of law."<sup>17</sup> Thus, New York courts have found pay-if-paid provisions enforceable where the contract is governed by state law that allows such provisions.<sup>18</sup>

### **Conclusion**

Subcontractors entering into contracts in New Jersey (where the choice of law is New Jersey) should carefully review the terms of the contracts for any payment contingency provisions, which may leave them with no immediate recovery if the owner does not pay the general contractor. In New York, all parties to construction contracts, whether general contractors, subcontractors or owners, must be aware that explicit clauses conditioning payment to the subcontractor on the owner paying the general contractor will not be enforced. If the parties are not New York entities and they desire to include a pay-if-paid provision, they should determine whether their state allows such provisions, and if so, have their contract governed by that state's law. ■

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### **Endnotes**

1. See *Fixture Specialists, Inc. v. Global Construction, LLC*, 2009 WL 904031/2009 U.S. Dist. LEXIS 27015 (D.N.J. March 30, 2009).
2. *Id.* at \*4-5.
3. See *Id.* at \*5.
4. See *Id.* at \*16 (quoting *Avon Bros, Inc. v. Tom Martin Construction Co.*, 2000 WL 34241102 (App. Div. Aug. 30, 2000)).
5. See *Fixture Specialists, Inc.*, *supra*. at \*15.
6. See *Id.* at \*17-18.
7. See *Id.* at \*19-22 (citing *Thomas Group v. Wharton Senior Citizen Hous*, 163 N.J. 507, 519 (2000)).
8. See *Id.* at \*22.



9. *O.A. Peterson Constr. Co., Inc. v. Englewood Hosp. and Med. Ctr.*, 2010 WL 2696758/2010 N.J. Super. Unpub. LEXIS 1452 (App. Div. June 30, 2010).
10. *See Id.* at \*2.
11. *See Id.* at \*3.
12. *See Id.* at \*7.
13. *See West-Fair Elec. Contractors v. Aetna Cas. & Sur. Co.*, 87 N.Y.2d 148 (N.Y. 1995); *see also JC Ryan EBCO/H&G, LLC v. Lipsky Enters. Inc.*, 911 N.Y.S.2d 136 (N.Y. Sup. Ct. 2010); *Nevco Contracting Inc. v. R.P. Brennan Gen. Contractors & Builders, Inc.*, 33 N.Y.S.3d (N.Y. Sup. Ct. 2016).
14. *See West-Fair, supra.* at 158-59.
15. *See Id.* at 155-56.
16. *See Id.* at 158.
17. *Welsbach Elec. Corp. v. MasTec N. Am., Inc.*, 7 N.Y.3d 624,627 (N.Y. 2006).
18. *See Id.*; *see also Hugh O’Kane Elec. Co., LLC v. MasTec N. Am., Inc.*, 846 N.Y.S.2d 51 (N.Y. Sup. Ct. 2007).