Insurance, Surety & Liens

A Newsletter of Division 7 of the ABA Forum on Construction

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Message from the Chair

Dedication: The True Sense of the Word Comes from Within Division 7

Having now been involved in the Forum and, in particular Division 7 (Insurance, Surety and Liens), for over a decade and having the current privilege to serve as the Chair of Division 7, I have gained a greater appreciation of the dedicated individuals that have preceded me and laid the solid foundation needed for "Building the Best Construction Lawyers." During its planning retreat at the Fall Meeting in Chicago, Division 7's Steering Committee recognized the importance of re-engaging these dedicated individuals, many of whom are past Chairs and former Steering Committee Members, and want to pay homage to these folks by organizing

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In This Issue

Subcontractors Can Still Perfect Mechanic's Liens After Prime Contractors File for Bankruptcy

By: Phil J. Truax, Esq.
Wickens, Herzer & Panza

One of the most common and effective ways for a subcontractor to secure a payment claim is to file a lien. Assuming any applicable pre-lien notice requirements are satisfied, an unpaid subcontractor can lien a *private* project site, or the public fund or account payable to the prime contractor on a *public* project. But what is the impact when the prime contractor files a bankruptcy petition before the subcontractor perfects its lien? A recent case from the Fourth Circuit Court of

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Construction, Insurance, and Things That Go Bump!

By: Kevin J. Connolly, Esq.

No construction lawyer would admit to having inadequate knowledge of insurance coverage. The saying is too often heard to be ignored:

if you're ***in*** the construction business

but you're not properly insured

then it's only a matter of time before

you're ***out*** of the construction business

likely with a bang.

When insurance fails, the impacts can be catastrophic. The recurrence of coverage gaps can be traced to many things that are beyond the ability of counsel to address. Most policyholders, when they finally receive the policy documents, simply file them away unread. It is most likely that an even greater number of policyholders are unable to understand the myriad of documents that make up a package policy.

Counsel still has one clear opportunity to affect the insurance outcome, and that is in writing the construction contract. The contract represents the last best opportunity to share and allocate risks of all sorts. It is unmistakable that a construction contract will contain insurance terms. Coordinating the insurance terms with the construction terms is a daunting process that mandates a deep understanding of both the insurance policy and the construction contract.

It is of the utmost importance to coordinate the construction contract with the insurance coverage. Failure to do so can lead to foreseeable losses that could have easily been avoided. The AIA's own website warns that the insurance terms in the "flagship" A201 form are in need of adjustment:

> "The provisions of this article commonly require expansion. Insurance coverages that the contractor is required to carry <u>should be clearly stated in the contract</u> documents so that the contractor can accurately calculate its costs. The owner's legal counsel and insurance adviser should make appropriate recommendations to the owner on insurance and bonds" (emphasis added.)

Furthermore, Paragraph 11.1 addresses the contractor's liability insurance. Subparagraph 11.1.1 requires that the insurance be purchased from a company "lawfully authorized to do business in the jurisdiction in which the Project is located." This is a lawyer's clause that leaves insurance people puzzled about the acceptability of "Excess & Surplus

Paper." The subparagraph continues with a mandate that the contractor purchase enough insurance to protect against a laundry list of claims. A reasonable interpretation of the AIA's own commentary on Article 11 amounts to an admission that the A201 form is rubbish.

The balance of 11.1.1 enumerates the required lines of coverage to include workers' compensation, employers' liability, bodily injury, personal injury, property damage, automobile, completed operations and "claims involving contractual liability insurance under Section 3.18." The required coverage can be obtained with commercial general liability and workers' compensation policies, with one exception: contractual liability insurance.

"Contractual Liability Insurance" is a misnomer. There is no such thing. Contractual Liability is an exclusion. The contract should specify that the policy contain an "Insured Contract Exception" that is at least as favorable as a reference standard, such as the ISO's Commercial General Liability policy, e.g. CG 00 01.

Another clause that often requires adjustment is subparagraph 11.1.2. It refers the reader to the contract documents for the required limits of liability. It also addresses when the contractor's duty to provide insurance lapses.

Many policyholders mandate that if the policy covers construction-related losses then the policyholder must be covered as an additional insured on the insurance policy of the top-level constructor. Contractors are required to be covered on the policies of their subcontractors. Counsel must be aware that coverage of parties, other than immediate contract parties, is complex. The usual forms employed by insurance professionals will not make the owner an additional insured under a subcontractor's policy. Counsel should also be aware that an additional insured party's coverage can lapse without any notice to the additional insured.

Subparagraph 11.1.3 requires the filing of insurance certificates by the Contractor. Reliance on insurance certificates is misguided. The ACORD insurance certificate bears a legend in the upper right hand corner, which provides that the certificate is worthless. It does not change or amend any of the terms of the policy and confers no rights on the certificate holder. Certificates are a convenient record for administrative purposes, but nobody should rely on them. Instead, what is needed is a provision for the contractor to deliver the policy itself. This is especially important if the owner is to be named as an additional insured on the policy, since additional insured status requires an endorsement to the policy.

Another problem in 11.1.3 is the requirement that the certificate provide that the policy will not be cancelled or allowed to expire until after at least thirty days' notice is given. The ISO standard policies are quite different. Notice of cancellation is given to the First Named Insured, and only that party needs to be notified to effectively cancel the policy. The standard ISO coverage form provides that the company will endeavor to give notice to a certificate holder, but such notice is not a condition to the carrier's cancellation. Moreover, cancellation for non-payment calls for only ten days' notice, and expiration of a policy puts an end to it without notice. The common policy conditions do contain terms that require the carrier to give the First Named Insured at least 45 days' notice if it decides not to renew the policy.

There is a provision in 11.1.3 that is probably more honored in the breach than in the observance: "Information concerning reduction of coverage on account of revised limits or claims paid under the General Aggregate, or both, shall be furnished by the Contractor with reasonable promptness in accordance with the Contractor's information and belief." As a general rule, the exhaustion of the aggregate limit is not something that the contractor is aware of, let alone something that is reported to the owner.

11.1.4 limits the requirement for additional insured party coverage

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(Unlicensed Contractors Can Maintain Suit Against Miller Act Payment Bond Despite State Laws to the Contrary—Continued from page 1)

Appeals indicates that the subcontractor's lien interest is protected from any bankruptcy stay, and the subcontractor can still file its lien and secure its claim for payment.

In the case *In re Construction Supervision Services, Inc.*, 753 F.3d 124 (4th Cir. 2014), a group of subcontractors furnished materials and equipment on various construction projects to Construction Supervision Services, Inc. ("CSS"), who acted either as a prime contractor or a first-tier subcontractor. CSS failed to pay the subcontractors' accounts for the materials provided, and then filed a Chapter 11 bankruptcy petition in January, 2012. CSS's subcontractors still attempted to file their liens against project funds that were owed to CSS, and asked the bankruptcy court for a ruling on the scope of the stay to permit the perfection of their lien claims without violating the stay.

Generally, when a bankruptcy petition is filed, 11 U.S.C. § 362(a)(4) provides for an automatic stay of any attempts by creditors to collect on their claims against the debtor. But among other exceptions, section 362(b)(3) provides protection from a stay for any creditor with an interest in property that predates the bankruptcy petition but is not yet perfected at the time the debtor files for bankruptcy (assuming, in the absence of the bankruptcy filing, the perfected interest would be effective against a third party acquiring rights prior to that perfection). *In re Construction Supervision Services, Inc.*, 753 F.3d at 126.

In *Construction Supervision Services*, in response to the subcontractors' request for clarification on the stay and confirmation that its post-petition notices were proper, the bankruptcy court held that the subcontractors "had an interest in property upon delivery of the materials and equipment, i.e., before lien notice and perfection… [A]nd because all other requirements for the pertinent stay exception were concededly met, the Subcontractors were not stayed from noticing, i.e., perfecting their liens." *Id*. at 127. After an unsuccessful appeal to the Federal district court, CSS's lenders appealed to the Fourth Circuit Court of Appeals.

Relying on law from the First and Seventh Circuits (among other sources), the Fourth Circuit affirmed. The Court held that the subcontractors had an interest in the property of CSS, despite the fact that they had not yet served notice, and therefore had not perfected their lien claim under the applicable North Carolina lien statutes prior to CSS's bankruptcy filing. The subcontractors' lien rights arose when the materials and equipment were furnished, not when they served notice of their lien claims. Thus, the subcontractors had an interest in property at the time CSS filed its bankruptcy petition, and the exception under section 362(b)(3) applied to permit the subcontractors to perfect their lien interests post-petition.

Before concluding that *In re Construction Supervision Services, Inc.* means a subcontractor or material supplier can perfect its lien even after a prime contractor has filed for bankruptcy protection, a careful review of one's own state mechanic's lien statutes is necessary. However, many states have mechanic's lien laws like North Carolina's: a contractor's or supplier's lien rights are created when the labor, material or equipment is furnished (as opposed to when the lien is perfected). *See e.g.*, *Forsgren Associates, Inc. v. Pac. Golf Cmty. Dev. LLC*, 182 Cal. App. 4th 135, 146-47 (2010) ("a mechanic's lien attaches to the improved property when the first labor or construction material is furnished for the construction work."). *But see In re McDonald,* 163 F. Supp. 951, 952 (E.D.N.Y. 1958) (holding that a material supplier had no lien "inchoate or otherwise" until notice is filed). As such, a subcontractor or supplier should be prepared to continue efforts to perfect its lien rights even if the project's prime contractor files for bankruptcy.

Phil J. Truax, Esq.
Wickens, Herzer & Panza
35765 Chester Road
Avon, Ohio 44011
ptruax@wickenslaw.com
www.wickenslaw.com

to instances where the loss is caused by the negligent acts or omissions of the contractor. There is no good reason to limit these claims to negligence: the insurance policy responds to claims that arise out of the operations of the named insured party, regardless of whether the negligence of the named insured caused the loss.

It is clear that Section 11.2 needs improvement. It calls for the owner to carry the "usual liability insurance." One can make an educated guess at the meaning of this term. However, contract law does not reward guesses nor should it. The need to supplant this provision with something meaningful is patent.

The real sore spots in the insurance article, however, are in Section 11.3.

Subparagraph 11.3.1 calls for the owner to maintain property insurance written on a builder's risk "all risk" or its equivalent policy form. The most obvious problem is that "all risk" insurance forms were withdrawn from the market in 1986. The modern terminology is "special causes of loss," but that is only the tip of the iceberg.

The AIA form does not provide for the use of Inland Marine forms, which provide broader coverage than the commercial property form of builder's risk policy.

Subparagraph 11.3.1 continues with a requirement that the policy cover the work on a replacement cost basis. Many, if not most, policies that cover buildings in the course of construction, value the loss on an Actual Cash Value basis. The difference between the two basses is simple: ACV = Replacement Cost – Depreciation. In those cases where the insurance program is established when the contract is awarded, a moment's attention to the valuation clause is all it takes to bring the general conditions and the insurance into alignment.

Clause 11.3.1.1 blesses us with a provision that the insurance must be written on an "all risk" basis, but then continues with a list of named perils that must be covered. The list includes a reference to the long-obsolete "extended coverage" concept. Coordinating the A201 with the insurance calls for attention to several things.

First, ascertain whether the policy is a commercial property form. If so, the contract should call for the Special Causes of Loss form (if open peril coverage is desired) or for the Basic or Broad form of Causes of Loss if "named perils" is acceptable. If the policy is going to be written on an Inland Marine form, one will need to actually read the policy, because the causes of loss in an IM policy are incorporated into the policy instead of being stated on a separate form. IM forms are almost always better coverage but they have to be read on a case-by-case basis. They are often largely manuscript policies.

Second, keep in mind that the A201 requires coverage for loss during testing and startup. Those operations have been known to cause parts of the work to fail, and spectacularly so. If the failure occurs during hot testing or startup, it most likely is due to pressure, temperature, centrifugal force, or electrical mishaps. All of these, however, are excluded causes of loss under a commercial property form. If the builder's risk policy is written as commercial property coverage, then a separate policy that covers mechanical breakdown is essential. If the policy is written as Inland Marine coverage, it will typically include coverage for testing and startup, but it is always a good idea to Read The Fine Print.

The requirement that temporary buildings be covered is usually minimal. The Commercial Property form (and most IM forms) cover temporary buildings automatically if the named insured is required by contract to insure them. However, if the Builder's Risk insurance is obtained by the contractor, then the temporary buildings will not be covered by the Builder's Risk policy. They can be covered by the Contractor under its Building & Personal Property coverage.

The A201 also requires coverage for debris removal, including demolition occasioned by enforcement of any applicable legal requirements. However, debris removal is paid out of the limits of

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liability that also pay for the cost of of reconstruction. If the cost of repair or reconstruction exhausts the limits of liability, the policy will pay a maximum of $10,000 over the insurance limits for debris removal. In any case, the payment for debris removal is limited to 25% of the amount paid for the repair/reconstruction. All of these provisions may be different if an Inland Marine form of policy is in use.

Be aware that the Commercial Property form of Builder's Risk coverage specifically excludes costs occasioned by the enforcement of any law. That kind of coverage requires a specific endorsement, CP 04 05, which does pay those costs. However, obtaining such coverage is far from ordinary. More feasible is coverage for Increased Costs of Construction.

Soft costs occasioned by the casualty, such as architect/engineer fees, are not covered by the commercial property form of Builder's Risk insurance. Some Inland Marine forms cover these expenses, but to find out if any given policy covers soft costs, it is necessary to examine it.

Subparagraph 11.3.1.4 requires the property insurance to cover portions of the Work stored offsite or in transit. The Commercial Property form does not cover anything unless it is at the site or within 100 feet of it. Some IM forms cover portions of the work located anywhere in the world. The alternative is to procure installation floater coverage, which is specific to identified movable property.

Subparagraph 11.3.1.5 addresses partial occupancy. This can have a critical impact on coverage. While this discussion has generally shown that IM coverage is superior to commercial property coverage, the superiority is not uniform. Coverage under the Commercial Property form ends (among other things) sixty days after partial occupancy, unless the carrier agrees to extend coverage. Under an inland marine policy, however, partial occupancy terminates coverage automatically because partially-occupied construction may not legally be treated as an inland marine risk. There is no grace period under most IM policies that terminate under this cause because coverage of completed construction is prohibited as an IM exposure.

Subparagraph 11.3.2 requires "boiler and machinery coverage." This provision is required by the contract documents or by law. The coverage that used to be referred to as "boiler & machinery" is now denominated "equipment breakdown," and the coverage is effected through dedicated policies as well as the terms of many IM forms.

Subparagraph 11.3.7 is the "waiver of subrogation" provision, and that too is a misnomer. The construction contract does not waive subrogation; in fact, it waives the underlying right of recovery. Remember that subrogation is an equitable remedy that (among other things) permits a property insurer that pays for a loss to step into the shoes of its insured and to recover from parties that are legally responsible for the loss. This subparagraph waives the right of the damaged party to recover damages from the other party for a loss that is covered by property insurance. Once that underlying right has been waived, the party no longer has a right of recovery, so when the carrier steps into the shoes of the insured, it acquires no rights. However, attention to the terms of the insurance policy is critical. The standard ISO Builders Risk policy permits the insured to waive its recovery rights so long as it does so before the loss occurs. Such a waiver has no impact on the rights of the insured under the policy.

Other policies have differing provisions. Some of these provisions result in added premium charges, while others raise a risk that the coverage will be void. In the latter case, it is important to either secure an endorsement that waives subrogation, or to excise the waiver of the right of recovery from the contract document.

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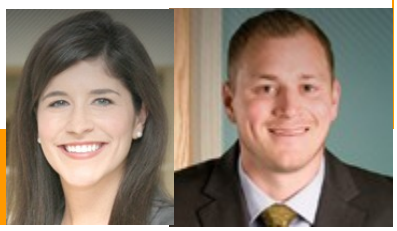
Owners should be aware that under the commercial property forms published by ISO, waiving the right of recovery against an architect or structural engineer results in a 500% increase in the premium for coverage against collapse during construction.

In addition to coordination, counsel should be aware of the realities of construction. Materials are sometimes used even though they do not conform to the contract documents. There may be no other way to complete the project on time. However, the risk of loss to such goods remains with the seller until they are accepted, even though it is obvious that the buyer will install the non-conforming goods and adjust the price.

In conclusion, it is imperative that counsel work closely with their clients to make sure they understand and appreciate the associated risks when entering into a construction contracts. It is equally important that counsel coordinate those contracts with the insurance coverage.

Kevin J. Connolly, Esq.
Kevin J. Connolly
New York, New York

Payback Time: Prevailing Wage Underpayment Claims Against Subcontractor Bonds



By Jason T. Farley and Sarah S. James
Whitfield & Eddy, P.L.C.

I. Introduction

The Davis-Bacon Act's (DBA) wage and fringe requirements changed the practical realities of engaging in federal construction projects. DBA has had a particularly noticeable and growing impact on these projects over the last three years as the Department of Labor (DOL) has increased its investigations in the construction industry. Subcontracting requirements contained in the Federal Acquisition Regulations (FARs) have become especially important as prime contractors and Miller Act bond sureties—faced with increased exposure for underpayment claims—seek to pass responsibility for DBA violations downstream to the offending subcontractor or lower-tier subcontractor. This Article will discuss the impact these underpayment claims have on subcontractor bonds.

II. Davis-Bacon Act

DBA was originally passed in 1931 to protect construction workers from the severe and prolonged decline in wages that workers had experienced since the late 1920s. DBA generally establishes a minimum amount of wages and fringes, computed by the Secretary of Labor, based on labor classification and geographical area for a particular type of construction. It requires prime contractors, subcontractors, and lower-tier subcontractors performing work on certain federal projects to pay workers at least the prevailing rates for workers on projects of a similar character in the area. It also requires advertised specifications for all contracts covered by DBA to include certain clauses that outline the legal stipulations of the Act.

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a Leadership Circle. Pat Poff, former Division 7 Chair, is currently recruiting members to Division 7's Leadership Circle. Please contact Pat at ppoff@trenam.com if you are a former Chair or Steering Committee Member of Division 7 and are interested in being "re-engaged."

Consistent with the "dedication" theme of this message, I want to express my sincere appreciation to the Steering Committee Members who showed up in mass for Division 7's planning retreat, including two Steering Committee Members who traveled great distances to contribute to the retreat even though they were unable to attend the Forum's program due to work conflicts. As a result of the dedicated efforts of the Steering Committee, the planning retreat was a success! The ground work has been laid for another successful year for Division 7 with lots of opportunities for current and new members to "plug-in."

Division 7 will be compiling a 50–State Mechanic's Lien Desk Reference for practitioners and in -house counsel alike. This will be a user-friendly summary of the Mechanic's Lien laws for each state. Division 7 recognizes that there are several competing compendiums of Mechanic's Lien laws. However, Division 7 feels strongly that, in order to best serve its constituents, it must be a "go -to" source for this information as well. If you are interested in contributing to Division 7's 50-Sate Mechanic's Lien Desk Reference, please contact me.

We are also compiling comments to the insurance and surety clauses of the AIA A201-2007 in anticipation of the AIA's roll-out of the 2017 standard contract forms. Josh Ballance has created a template for anyone to provide their comments to the current insurance and surety clauses. Please send an email to Josh Ballance at JoshuaBallance@aia.org if you would like a copy of the template in order to provide comments.

In addition to these initiatives, Division 7 will continue to publish a quarterly newsletter and host bi-monthly Hot Topics presentations during its conference calls on the first Thursday of each month. Division 7 is also focused on increasing its social media presence, including its new LinkedIn page. Please visit https://www.linkedin.com/groups?gid=8210184 to sign up for Division 7's LinkedIn page.

Again, thanks to all the dedicated folks who make Division 7 and the Forum the preeminent resource for "Building the Best Construction Lawyers."

Daniel P. King
Frost Brown Todd LLC
201 North Illinois Street, Suite 1900
Indianapolis, Indiana 46244

dking@fbtlaw.com
www.frostbrowntodd.com
P: 317.237.3800
F: 317.237.3900

DOL and, more specifically, its Wage and Hour Division (WHD), is charged with enforcing the DBA. WHD staffs investigators, supervisors, and various levels of technical and clerical employees to carry out enforcement procedures. WHD can either conduct an investigation on its own or direct the contracting agency administering the targeted project to do so. It is common for the contracting officer—the government representative presumeably most knowledgeable regarding the project—to lead the investigation. WHD can elect to investigate an employer for a number of reasons. Most commonly, these investigations are initiated when a complaint has been made to WHD against an employer; however, DOL can and has launched its own investigations of industries know to pay low-wages. Specifically, DOL has targeted industries with high rates of violations, industries with vulnerable workers, or industries with a dramatic change in size over a short period of time.

WHD investigations follow a specific procedure that is set forth in DBA and its corresponding regulations. During an investigation, WHD staff examine the employer's records, including payroll and time records, interview certain employees, and meet with the employer and its surety. WHD can use any contract funds withheld by the contracting agency (on any of the prime contractor's federal contracts, not just the targeted project contract) to pay employees back wages, and once those funds are gone, employees have the right to pursue reimbursement directly from the prime contractor and its surety. Further, the contract can be terminated, the contract may be completed by others at the prime contractor or its surety's expense, and the contractor may have its license revoked(is there a federal bar contractors are placed on?) for up to three years.

III. Increased Enforcement

Over the past few years, WHD has significantly increased—in terms of frequency and scope— investigations in the construction industry. A number of factors are likely related to this uptick in enforcement activity. One reason is that DOL has identified the construction industry as "high risk" because it employs a large number of workers at a relatively low wage, and the potential for abuse and misclassification is high. DOL has made clear that it hopes through heightened enforcement in targeted areas, such as the construction industry, employers will better understand the laws and compliance will increase. Further, the explosion of the internet and expanded availability of information have provided greater access to employees of their perceived workplace rights and violations by employers. This has led to a rise in employees pursuing legal guidance with respect to potential violations. Correspondingly, complaints to WHD are on the rise, and DOL has made enforcement a priority.

The prime contractor bears ultimate responsibility for DBA compliance on the project. Accordingly, DBA provides just one remedy: the contracting authority can suspend payment to the prime contractor and pay the withheld payments directly to the underpaid workers and/or, in the event the withheld funds are insufficient, the underpaid worker can pursue a claim directly against the prime contractor and its surety. As one federal court explained: "[P]rime contractors —**not intermediate subcontractors**—are accountable for lower tier subcontractors' compliance with the regulations." Moreover, "[t]he prime contractor is liable for wage underpayment made by its subcontractor whether the prime contractor had knowledge of the violations and despite good faith on the part of the prime contractor." An assessment against the prime contractor is possible for any violation of the labor standards defined in DBA.

IV. Subcontract Requirements

To ensure subcontractor and lower-tier subcontractor compliance, the FARs require prime contractors, subcontractors, and lower-tier subcontractors to include specific clauses in their respective subcontracts to bind all tiers of subcontractors to DBA requirements. These subcontracting requirements

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have become especially important as prime contractors and Miller Act sureties—faced with elevated exposure for underpayment claims—seek to pass responsibility for DBA violations downstream and ultimately to the offending employer.

Courts have provided little guidance on the issue of subcontractor and lower-tier subcontractor responsibility for a DBA violation. In fact, just two cases have addressed situations involving a higher-tier contractor (either prime contractor or subcontractor) asserting a claim against a lower-tier contractor in an attempt to pass responsibility for a DBA violation downstream. In *Dorey*, the court considered the issue in the context of whether federal question jurisdiction existed for a prime contractor's breach of contract claim against a subcontractor by which the prime contractor sought to pass responsibility for a DBA violation to the subcontractor. In holding that federal question jurisdiction did not exist, the court concluded that DBA did not create an implied right of action in favor of the prime contractor against a subcontractor (or its surety). The court explained:

> Under the Davis–Bacon Act, congress has devised a system whereby payment may be withheld from the prime contractor for violations of the Act by the prime contractor or its subcontractors. 40 U.S.C. § 276a(a). Congress further guaranteed that employees of both the prime contractor and any subcontractors could look to the prime contractor for relief from inadequate wages by providing a federal cause of action for those laborers against the prime contractor's Miller Act bond should administrative withholding prove to be an inadequate remedy. 40 U.S.C. § 276a –2(b). **This Court must assume that Congress knew what it was doing when it placed upon the prime contractor the initial liability for subcontractors' violations of the Davis-Bacon Act. By declining to provide a federal remedy to prime contractors against subcontractors in violation or their sureties, Congress appears to have intended to relegate those prime contractors to their state law remedies for breach of contract.**

In *D.L.I.*, the court considered the issue in the context of a subcontractor's preemptive payment of the amount of a DBA assessment pending resolution of its claim against a second-tier subcontractor by which the subcontractor sought to pass responsibility for the violation to the second-tier subcontractor. In that case, the subcontractor and second-tier subcontractor entered into a written subcontract that covered some, but not all, portions of the second-tier subcontractor's work. The written subcontract included several clauses that appeared to place responsibility for DBA compliance on the second-tier subcontractor. Other portions of the work, however, were covered by an oral agreement. The oral agreement was simply an understanding that the work would be performed and paid on a time and material basis, and therefore did not include terms related to DBA compliance. The DBA assessment was based on work performed

In its analysis, the court distinguished between the amount of the assessment related to work covered by the written subcontract and the amount related to work covered by the oral agreement. The court made this distinction on the basis that each contained differing terms (not based on the fact that one was written and one was oral). With respect to the work covered by the written subcontract, the subcontractor argued that the subcontract provisions made the second-tier subcontractor responsible for DBA compliance. The court agreed, and concluded that "these provisions make clear that [the second-tier subcontractor] owed a contractual duty to comply with Davis-Bacon, and that when

[the second-tier subcontractor] breached this duty, [the subcontractor] acted within its contractual rights in remitting payment to DOL for the DBA claim and withholding that amount from [the second-tier subcontractor]."

With respect to the work covered by the oral agreement, the subcontractor contended that the second-tier subcontractor was responsible for compliance, even in the absence of contract terms that would place responsibility for compliance on the second-tier subcontractor, based on principles of incorporation by law, constructive knowledge, actual notice, and equities. The court rejected these contentions, however, and determined that the subcontractor had no legal basis to back charge the second-tier subcontractor by withholding the amount. The court's conclusion was simple: "notice does not equate to liability."

Dorey and *D.L.I.* imply that in order for a higher-tier contractor to pass responsibly for DBA violation(s) downstream, the applicable subcontract must require DBA compliance. A leading labor and employment law treatise is in exact accordance with this principle:

> As a general rule, the prime contractor is responsible for ensuring its subcontractors' compliance with Davis-Bacon. Thus, "the prime contractor is liable for wage underpayment made by its subcontractor whether the prime contractor had knowledge of the violations and despite good faith on the part of the prime contractor." This means that although subcontractors' employees must be paid prevailing wages, the subcontractor is not liable per Davis-Bacon, only the prime would be liable for its failure to oversee compliance. **Therefore, subcontractors' only responsibility to the prime contractor to pay Davis-Bacon rates (and to indemnify the liability of the prime contractor pursuant to those rates), is through the contractual language between prime and subcontractor.**

The existing case law highlights the importance of the FAR subcontracting requirements and the language in the actual contracts between the prime contractor, subcontractor, and any lower-tier subcontractors. Sloppy subcontracting simply will not suffice. It is essential that all contracts on DBA projects are in compliance as courts appear willing to hold the prime contractor responsible for all DBA violations on the project. From there, liability must contractually flow downstream to the offending contractor.

V. Increased Exposure for Subcontractor Bond Sureties

Subcontractor bonds have become increasingly common on federal projects. In the current climate of heightened enforcement efforts by DOL in the construction industry, sureties face unprecedented exposure for underpayment claims against subcontractor bonds. Claims against subcontractor bonds are governed by the terms of the bond and principles of contract interpretation. While surety defenses may require discovery and can become contested factual disputes in themselves, sureties should utilize defenses as early as possible in litigation to eliminate, as a matter of law, liability for an underpayment claim. While attorneys and sureties must evaluate various defenses available in the applicable jurisdiction, some potential defenses include:

- Principal liability. As discussed above, responsibility for a DBA violation must contractually-flow from the prime contractor downstream to the offending contractor. The subcontractor bond surety must make sure that the principal is, in fact, responsible for the DBA violation.

- Performance and/or payment claim. The underpayment claim may be covered by either the performance bond or the payment bond. Certain bond defenses may be available depending on which bond provides coverage.

- Standing. The claimant in an underpayment claim against a subcontractor bond is usually the contractor immediately upstream from the offending contractor—either the prime contractor or a higher-tier subcontractor. To have standing to assert a claim, the claimant must be a defined claimant under the applicable bond.

- Default as a condition of liability. Surety liability is often conditioned upon contractor default. When the underlying performance bond conditions the surety's liability upon the principal's default, an argument may be available that no post-competition breach of a bonded contract can trigger the surety's potential liability. This argument is premised on the distinction between breach and default, and the theory that no material breach of contract—and therefore no default—can occur after the bonded contract is completed.

- Statute of limitations. Many performance and payment bonds contain one- or two-year statutes of limitation with commencement dates tied to the date of the principal or claimant's last work on the project. Because WHD investigations do not necessarily begin during or immediately after the targeted project, and the procedure takes additional time to complete, by the time a claim is asserted it may be time-barred purpose of such penalties: to deter future violations by the employer. Unless there was a contrary agreement, a surety is likely not liable.

- Deprivation of due process/estoppel. A deprivation of due process or estoppel argument might exist if the surety (or principal) is deprived of an opportunity to present evidence or appeal the decision of WHD with respect to alleged violations.

VI. Conclusion

The Obama Administration's proposed budget for fiscal year 2015 suggests that DOL does not plan to diminish its focus on the construction industry and enforcement of DBA. To the contrary, a proposed budget requesting an increase of more than $41 million in funding for WHD suggests just the opposite. It is exceedingly important that attorneys and sureties have a basic understanding of DBA and corresponding regulations to take preventative steps, continue to proactively audit and assess current pay practices, review exemptions, and educate employers about the impact of DBA. Taking preventative action to ensure DBA compliance may protect subcontractor bond sureties from expensive DOL investigations and litigation.

Jason T. Farley, Esq.
Whitfield & Eddy P.L.C.
317 6th Avenue
Des Moines, IA 50309

farley@whitfieldlaw.com
www.whitfieldlaw.com
P: 515.246.5516
F: 515.246.1474

Sarah S. James, Esq.
Whitfield & Eddy P.L.C.
317 6th Avenue
Des Moines, IA 50309

james@whitfieldlaw.com
www.whitfieldlaw.com
P: 515.246.5523
F: 515.246.1474

Editor's Corner

Steven M. Cvitanovic, Editor

I hope you enjoy this fourth and final newsletter for the year, and what a year it has been. 2014 will be remembered as a year where things sizzled in the economy and the construction industry. The construction industry took a major hit after the 2008 downturn and many contractors were not able to survive long enough to see the current bonanza in building. The Holidays are a good time to reflect on how much things have improved and how much the industry has changed in the last five to ten years.

Like much of the United States, the construction industry is hitting on all cylinders out here on the West Coast. It seems like every metropolitan area has a number of large projects underway and miles and miles of construction zones and torn-up streets. So next time you are in a traffic jam and running ten minutes late to the office because some flatbed loaded with iron is blocking the street, or that cement truck can't seem to go any faster than 10 mph, take a moment to think about how these jobs have breathed life back into our economy and how these projects will improve our lives. Take a moment to think how much you will enjoy the future restaurant going into that mixed-use high-rise under construction. Take a moment to think of how much fun it will be to take the family to the new stadium that is taking shape. Take a moment to think of how that hospital will deliver world-class heath care for you and your family.

It is not just *that* these project are getting built, it is *how* they are getting built that sets this construction boom apart from prior booms. Owners and designers are not just settling on building projects, they are striving to build architecturally groundbreaking, functional, and sustainable projects. Contractors have risen to the challenge presented by this generation of projects by finding new construction techniques, agreeing to new delivery models, and using cutting-edge technology.

These pioneering projects offer novel challenges to contractors in adhering to contract requirements. Construction documents and specifications have grown more complex than ever before. Success on any given project not only depends on proper execution in the field, but also on having a solid understanding of contract requirements before signing. While AIA, ConsensusDocs, and EJCDC Contract Documents have some similarities, they also vastly differ in discrete ways.

It is dangerous for contractors to assume that there is a "standard" contract or a "standard" way of doing things. Standard "form" contracts often need to be modified -- sometimes significantly-- in order to conform the contract requirements with actual conditions on the ground or to achieve a better distribution of risk. As illustrated by Kevin Connolly's article, the insurance requirements for the AIA A201 General Conditions of Construction Contract must be looked at closely to ensure that the coverage is suitable for the contractor and the project. If A201 is left unchanged, the contractor could very well end up having no coverage for a claim and be left on the hook for substantial uninsured liability exposure.

A contractor's failure to understand a contract can spell trouble in innumerable ways. Take for example David-Bacon Act compliance. This month's edition has an article by Jason Farley and Sarah James about the severe consequences that may arise when a prime contractor fails to understand Davis-Bacon Act requirements and include complying terms in a subcontract. The fact that Davis-Bacon Act liability will likely flow to the prime contractor's surety only heightens the importance of understanding the contract.

Finally, and perhaps of primary importance for the upcoming holiday shopping season, Phil Truax discusses getting paid. Nothing throws a project into disarray more

than the bankruptcy of a key party. However, as discussed in Phil's article, a bankruptcy of the prime contractor may not necessarily mean subcontractors or suppliers cannot perfect liens against project funds owed to the prime contractor.

In closing, and on behalf of the Division 7 Publications Subcommittee and Chair Dan King , we wish all of you a safe and happy Holiday Season.

Steven Cvitanovic
Haight, Brown & Bonesteel, LLP
Three Embarcadero Center
Suite 200
San Francisco, CA 94111

P: 415.546.7500
F: 415.546.7505

scvitanovic@hbblaw.com
www.hbblaw.com

Division 7 Member Spotlight

By: Mark Bell

Mark is an attorney in the Nashville office of Waller, Lansden, Dortch & Davis. He focuses on insurance matters for construction clients in transactions and disputes. He has been awarded the Chartered Property Casualty Underwriter (CPCU) insurance designation and frequently writes on insurance-coverage issues, publishing articles in The Connecticut Insurance Law Journal, the Construction Lawyer, Appleman on Insurance, Vanderbilt Law Review En Banc, Ohio Northern University Law Review, Faulkner Law Review, Northwestern Interdisciplinary Law Review and other online publications. His publications also include multiple online articles including articles in BloombergBNA, Law360, and Risk & Insurance online. He also serves as an editor for the CGL Reporter and contributes a regular column on construction liability insurance as an invited expert commentator with the International Risk Management Institute (IRMI).

Mark advises clients on manuscripting insurance policies and forming captives. He has also represented clients in complex insurance-coverage disputes involving builders risk, commercial general liability, directors and officers, cyber, commercial property, and professional liability insurance. One such example is when he successfully represented a policyholder in a CGL dispute before the 6th Circuit Court of Appeals affirming the trial court's decision in *Forrest Construction v. The Cincinnati Insurance Co.*, 703 F.3d 359 (6th Cir. 2013).

Mark is married with four children. He is an avid BYU fan and enjoys playing basketball and following mixed-martial arts in his free time.

Mark Bell
Waller, Lansden, Dortch & Davis, LLP
mark.bell@wallerlaw.com
www.wallerlaw.com