Welby, Brady & Greenblatt, LLP
ATTORNEYS AT LAW

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REPORT

WELCOME

Message to our Readers

Thank you for reading the Summer 2015 issue of the Welby, Brady & Greenblatt, LLP Construction Repot. We are pleased to bring you a summary of new legal happenings related to the construction industry as well as highlight the impact Firm Partners and Associates are making on the Legal Industry and the markets we serve.

In this issue, we are pleased to present Legal Alerts written by our team. Greg Spaun, Partner, presents on Owner/Designer Required to Defend Negligent Misrepresentation Claim on Functional Equivalent of Privity Theory; and Geoffrey S. Pope, Of Counsel, discusses Subcontractor Loses Lien Due to Failure to Identify Public Benefit Corporation as Fee Owner of the Real Property.

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Owner/Designer Required To Defend Negligent Misrepresentation Claim On Functional Equivalent OfPrivity Theory

By: Greg Spaun, Partner, Welby, Brady & Greenblatt, LLP

Greg Spaun

Contractors who undertake construction projects and follow the plans of the designer may nevertheless find themselves on the defending end of a construction defect lawsuit. In such situations, it is tempting for the contractor to bring the designer into the lawsuit on a theory that the designer negligently represented that the plans were free of defects when, ultimately, they may not have been. After all, if the contractor followed the plans, then where did the defects come from? However, contractors who have attempted to do so over the past 25 years have faced a significant obstacle in the form of the Court of Appeals' holding in *Ossining Union Free School District v Anderson LaRocca Anderson (73 NY2d 417 [1989]). The holding of Ossining* is that absent a contract with the designer (which contractors almost never have), a contractor can only assert a negligent misrepresentation claim against the designer where the contractor has a relationship with that designer which is the "functional equivalent of contractual privity". In *Ossining*, the Court of Appeals set forth a three part test for asserting such claims notwithstanding the lack of a contract: (1) an awareness that the plans were to be used for a particular purpose or purposes; (2) reliance by a known party or parties in furtherance of that purpose; and (3) some conduct by the designer linking it to the party or parties and evincing the designer's understanding of their reliance. It is generally the second and third prongs, reliance by a known party and the conduct by the designer evincing its understanding of the known party's reliance, where

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these claims ordinarily fail. Moreover, since these issues are questions of law for a court, the overwhelming majority of these lawsuits are dismissed at the outset.

This author, in *North Star Contracting Corp. v MTA Capital Construction Company* (120 AD3d 1066 [1st Dept 2014]), recently had some success arguing the functional equivalent of privity theory against an owner/designer, overcoming the bar to such suits generally resulting from the holding in *Ossining*. The facts of *North Star* arose out of the MTA Capital Construction Company's construction of the new South Ferry subway station in Manhattan. The MTA CC (a sister agency to MTA/New York City Transit) retained Judlau Contracting to build the new station and Judlau, in turn, retained North Star to perform the required track construction work. There was never any contractual relationship between the owner/designer and North Star.

The plans for the construction required Judlau (North Star) to use three types of a newly designed Low Vibration Track (LVT) block. All three types were designed by MTA/New York City Transit. The specifications required North Star to procure these specially designed blocks from a specific manufacturer, Permanent Way Corporation (PWC), which North Star did.

In October of 2007, when North Star was installing the Type A Blocks, it discovered that the blocks were defective in that the concrete screw inserts (which were crucial to attach the rails) were skewed. After the discovery of the defects, the owner/designer conducted an investigation into the origin of the defects (from which North Star was excluded, citing proprietary design and patent considerations). After this investigation, the owner/designer represented that it had reviewed PWC's manufacturing process for the Type DXO blocks to ensure that they would be satisfactory, and that PWC modified its quality control measures to ensure that those blocks would be free from defects. Unfortunately, similar to the Type A blocks, the Type DXO blocks suffered from the same defects. These defects caused North Star to incur losses resulting from the extra work required to replace the blocks, as well as associated delays to the project.

North Star sued the owner/designer asserting, amongst others, a claim for negligent misrepresentation. North Star alleged that it relied on the owner/designer's representations as to the suitability of the LVT Blocks and the owner/designer's investigation into (and assurances of the correction of) the defects with the blocks. The owner/designer moved to dismiss, citing the lack of a contractual relationship. The trial court dismissed the claims, finding that there was neither a contractual relationship nor a relationship which could be construed as the "functional equivalent of contractual privity".

On appeal, North Star's negligent misrepresentation claim was reinstated. In doing so, the Appellate Division found that there was the functional equivalent of contractual privity between North Star and the owner/designer. First, as to the awareness prong of the Ossining UFSD test, the appellate court noted that the owner/designer had a contractual relationship with Judlau, and that Judlau had a contractual relationship with North Star. That court also noted that the purpose of the North Star/Judlau subcontract was to further the purpose of the MTA/Judlau prime contract. As to the reliance prong of the *Ossining* test, North Star successfully argued that the owner/designer's designation of a sole-source manufacturer, coupled with its conducting an investigation from which North Star was excluded, left North Star no choice but to rely on the owner/designer's representations. Further, although contractually obligated to proceed with the installation, the appellate court found that North Star had the power to breach the contract if its demand for a written change order guaranteeing payment was not met, and that North Star refrained from doing so in reliance on the owner/designer's representations. Finally, as to the conduct linking the owner/designer to North Star, the appellate court found that the designation of a sole-source manufacturer, coupled with the undertaking of an investigation from which North Star was excluded—an investigation which gave the owner/designer unique or specialized expertise with regard to the design and performance of the Type DXO blocks—was sufficient to link the two parties.

While the facts of North Star may seem somewhat narrow, they do provide an opening through the *Ossining* wall for contractors who are working under contracts which call for sole-source procurement. Where a contractor is working under such an agreement and a problem arises with the sole-source product, that contractor may be able to assert a claim against the designer who called for the use of that specifically designated product.

Subcontractor Loses Lien Due to Failure to Identify Public Benefit Corporation as Fee Owner of the Real Property

By Geoffrey S. Pope, Esq., Of Counsel

Geoffrey S. Pope

The purpose of Articles 1 through 3-A of New York's Lien Law is to protect those who perform labor, or furnish materials, for the improvement of real property in the State. Although it is commonplace to see in the reported cases construing the statute the virtue that it is to be liberally applied, one should not make the potentially costly mistake of assuming that carelessness in the preparation, service and filing of a Notice of Lien will not have serious consequences for the aspiring lienor.

One common error is to fail to identify sufficiently, in the Notice of Lien, the real property as to which the lien (on a "private job") is intended to encumber title, or the identity of the "owner" (which term, as used in the Lien Law, may have a broader meaning than the actual fee owner of the property). Subcontractors, in particular, are liable to err as to the nature of the construction project as a "private job" or "public job," and/or the identity of the owner. Often, the use of a commercial company to attend to the preparation, service and filing of the lien will be an economy. It's not an economy, however, when the lienor is owed a large sum of money, a valid lien represents the best (or only) hope of getting the lienor paid, and the lien is invalidated because of the preparer's carelessness or errors.

Another error is to wait to file a lien until the statutory time to do so is about to expire. Lien Law § 12-a provides for the amendment or modification of a Notice of Lien. However, in addition to a requirement that the lienor make an application in court, there are three criteria which must be satisfied for the court to grant relief. First, the Notice of Lien, as filed, must be "valid." Second, the modification must affect an error that is not a substantive defect. Third, the modification must not be to the prejudice of another party. Often, a lienor will delay filing its lien until the eleventh hour. Such may be a product of mere procrastination, or they may be the result of the lienor's wish to delay or avoid antagonizing the party against which the lien is to be filed, with hopes of minimizing damage to the business relationship. The latter concern may be a valid one, but should not be indulged in without an appreciation of the risks.

If you file a Notice of Lien containing one or more errors, the errors in question may, or may not, be ones that can be corrected by an amendment. The line between a mistake that can be corrected by a court order allowing an amendment, and one that cannot, is not always clear. If a motion for leave to amend is uncertain to succeed, often the lienor's rights can be preserved by preparing, serving and filing a new Notice of Lien and cancelling the erroneous one filed previously. If, however, the time to file a Notice of Lien has expired, the remedy of substituting a new Notice of Lien will be unavailable as the new Notice of Lien will not "relate back" to the date that the first, defective, Notice of Lien was filed. While it's well and good to try to maintain amicable relations with a general contractor, developer or owner that owes you money, the later you file, the less time will remain to investigate and correct any errors that may be discovered.

The recent case of Metro Woodworking Inc. v. Hunter Roberts Construction Group, LLC, illustrates some of the pitfalls. Hunter Roberts was the general contractor on a project known as "Site 25," a hotel and retail complex in New York City. Metro Woodworking entered into a subcontract to perform millwork at "Site 25" for Hunter Roberts. Three days after that subcontract was terminated, Metro Woodworking — apparently believing the project to be a private job — filed a Notice of Lien with the County Clerk purporting to run against the real property and identifying "GS Site 25" as the fee owner. Metro Woodworking filed an action against Hunter Roberts, with causes of action for breach of contract, and for the foreclosure of its lien.

The Notice of Lien was dismissed by the court on motion. Alas for Metro Woodworking, not only was GS Site 25 not the fee owner of the premises (it was a sublessee), but the true owner was the Battery Park City Authority (BPCA), a public benefit corporation created under Public Authorities Law § 1983. As filed, Metro Woodworking's lien was invalid because BPCA is a public entity, and the filing of a private lien against a public entity affecting its real property is not permitted. Metro Woodworking's proper remedy was to file a public improvement lien. Such a lien would not have run against any real property, but only against amounts due or becoming due from whichever party was Hunter Roberts' contractee on the project.

Metro Woodworking made a motion to reargue or renew, asserting that the defect in identifying the interest of the

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"owner" was not irremediably fatal because (it asserted) the Lien Law requires only information to the best of the creditor's knowledge. The Court granted reargument but, upon reargument, adhered to its original determination, finding that a mechanic's lien on a leasehold interest cannot be filed against real property owned in fee simple by a public entity. Thus, the Notice of Lien filed against the Site 25 real property owned by the BPCA was not valid, was properly vacated upon the initial motion, and was not capable of being amended or modified.

"Allowing the modification of this lien," the Court reasoned, "would result in the transformation of a private lien into a public lien. Those liens are of two different kinds, filed in two different places, and differently published. [* * *] Metro Woodworking's services resulted in improvements upon the property belonging to BPCA, the public entity. As such, those improvements are public improvements, according to the Lien Law § 2(7) definition."

The Court also rejected Metro Woodworking's argument that it substantially complied with the Lien Law. Metro Woodworking argued that the lien was valid since the "owner" named in its Notice of Lien, GS Site 25, held a leasehold interest in the property; and, under the Lien Law a tenant (or subtenant) can be an "owner" against which a lien can be filed. While it is true, the Court found, that a lessee can fit within the definition of an "owner" in Lien Law § 2(3), this is true *only insofar as the subject matter of the lien is owned by a private entity*. Metro Woodworking complied with the Lien Law as the latter pertains to private improvements, not to public improvements. Nor could "substantial compliance" salvage Metro Woodworking's lien, the court found, because it substantially complied with the Lien Law *only as the same applies to a privately-owned real property*. Consequently, the first element necessary to give power to the court to authorize the amendment of the Notice of Lien — that the latter be valid as filed — was unmet. Wherefore, the motion for leave to amend the Notice of Lien could not be granted.

If you believe your lien to be for a significant amount of money, it may be a good investment to have a professional title search done before filing your lien. In any case, if you intend to file a lien at all, it's usually better to file as promptly as possible. It's important, too, to take pains to get the lien notice and filing procedures right the first time. The deadlines are relatively short and unforgiving, and you should not take it for granted that errors are unimportant because of the possibility of correcting them later via amendment under Lien Law §12-a.

Lien Law § 9 provides a checklist of what must be contained in a Notice of Lien on a private improvement. The requirements for the contents of a Notice of Lien on a public improvement are set forth in Lien Law § 12. The procedures and deadlines for service and filing are also set forth in the statute. Careful work in preparing, serving and filing a lien is critical, and a lack of care may be very costly.