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Ten Things to Consider When Drafting Construction Contracts Under New York Law

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Whether managing construction of a high-rise project in New York City, a power plant in India or a paper mill in Brazil, the legal disputes in any of those projects may be subject to resolution under New York law. While it is common for domestic construction-project disputes to be governed by the law where the project is located, on large, international projects as well as project-financed jobs, the contracts are often subject to New York law, where the financing parties and their legal counsel often are located. Drafters of such contracts, however, may want to be aware of restrictions by the New York legislature on the "freedom" to contract. Below are ten aspects to consider.

1. **Governing Law.** Provisions in private construction contracts that make contracts subject to the laws of another state are void and unenforceable. Section 757(1) of New York's General Business Law provides that a dispute arising from a construction contract must be resolved by New York state laws. The only exception to this prohibition is a contract with a material supplier.
2. **Forum Selection.** Provisions in private construction contracts that require dispute resolution in another state are void and unenforceable. Section 757(1) of the General Business Law provides that any litigation, arbitration or other dispute resolution arising from the contract must take place in New York state. The only exception to this prohibition is a contract with a material supplier.
3. **Suspension of Work.** Provisions that prohibit suspension of work under a private construction contract for nonpayment are void and unenforceable. Section 757(2) of the General Business Law provides that a construction contract cannot contain a provision "stating that a party to the contract cannot suspend performance under the contract if another party to the contract fails to make prompt payments under the contract."
4. **Periodic Payments—Disputes.** Parties to a private construction contract cannot avoid expedited and binding arbitration of disputes over nonpayment or late payment of periodic applications for payment. In September 2009, section 756-b(3) of the General Business Law was amended to allow a contractor, subcontractor or supplier to use arbitration as a permissive remedy for nonpayment. The statute now provides that where an owner, contractor or subcontractor fails to make a timely payment, the aggrieved contractor, subcontractor or supplier can use binding expedited arbitration to resolve the payment dispute. A provision in the parties' contract providing that arbitration is unavailable to one or both parties is void and unenforceable.[1] Thus, a nonpaying party can be required to participate in binding arbitration under the auspices of the American Arbitration Association, even though its construction contract does not contain an arbitration provision.
5. **Periodic Payments—Timeliness.** Parties to a private construction contract cannot change by contract the statutory-proscribed periods to pay an invoice. An owner must tender payment of an invoice, including final payment, within 30 days of the approval of the invoice.[2] A contractor or subcontractor must tender payment to its subcontractor of the proportionate amount paid by the owner for the subcontractor's work within seven days of having received payment for it.[3]
6. **Retainage.** Parties to construction contracts on public projects cannot agree to retention provisions of greater than five percent when the contract or subcontract is supported by a performance bond and a payment bond, and not

more than ten percent when no bonds are required or the subcontractor is unable or unwilling to provide such bonds.[4]

7. **Payment Remedies—Payment Bond.** A provision in a construction contract conditioning a subcontractor's or supplier's right to pursue a claim on a payment bond on exhaustion of other legal remedies is void and unenforceable.
8. **Indemnification.** Owners, contractors, subcontractors, architects and engineers are prohibited from passing along the risk of their own negligence to other parties.[6] Section 5-322.1 of the General Obligations Law provides that an indemnification provision in a construction contract that indemnifies or holds harmless the promisee against liability for damage arising from the promisee's negligence is void and unenforceable. Section 5-324 of the General Obligations Law provides that agreements by owners, contractors, subcontractors or suppliers to indemnify architects, engineers and surveyors from liability caused by or arising out of defects in maps, plans, designs or specifications prepared, acquired or used by such architects, engineers or surveyors are void and unenforceable. One court interpreted the statutes as serving the "particular needs for those least able to effectively fend for themselves. . . ."[7]
9. **Mechanic's Lien Rights.** Any kind of contractual language that attempts to limit or eliminate a contractor's lien rights is void and unenforceable. Section 34 of New York Lien Law provides in pertinent part: "Notwithstanding the provisions of any other law, any contract, agreement or understanding whereby the right to file or enforce any lien created under article two is waived, shall be void as against public policy and wholly unenforceable."
10. **Pay-When-Paid.** A provision in a subcontract making a general contractor's obligation to pay its subcontractor contingent on the general contractor's own receipt of payment from the owner for the subcontractors—commonly referred to as a "pay-when-paid" clause—is void as against public policy. New York courts reason that such a clause is contrary to public policy because it removes a subcontractor's right to enforce a mechanic's lien against an owner in contravention of section 34 of New York Lien Law.[8] Although New York courts are likely in theory to enforce a pay-when-paid clause when the contract is governed by the law of another state,[9] the New York Prompt Payment Act prohibits non–New York choice-of-law provisions in contracts for construction projects within New York state. Thus, it would appear that a pay-when-paid clause in a contract providing that it is governed by the law of another state would be enforceable only if the contract was entered into before January 14, 2003, the effective date of the statute.[10]

Richard P. Dyer practices in the area of construction law, including both contentious and non-contentious matters. Mr. Dyer has extensive experience in a broad range of construction, transactional and dispute resolution matters, including: preparation and negotiation of construction contracts, turnkey/design-build contracts, EPC contracts, construction management contracts, architect and engineer agreements, and trade contracts/subcontracts; contract administration; EEO and OSHA matters; surety bonding, mechanic's lien and insurance matters. He advises on the resolution of construction, engineering, and other commercial disputes through litigation, arbitration, including ICC-administered proceedings, and mediation.

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Notes

1. N.Y. Gen. Bus. Law § 757(3) (Consol. 2010).
2. N.Y. Gen. Bus. Law § 756-a(3)(a)(ii).
3. N.Y. Gen. Bus. Law § 756-a(3)(b)(ii).
4. N.Y. Gen. Mun. Law § 106-b, N.Y. State Fin. Law § 139-f.
5. N.Y. Gen. Oblig. Law § 5-322.1.
6. N.Y. Gen. Oblig. Law §§ 5-322.1 & 5-324.
7. *Ali El Chami d/b/a Everything Store v. Automatic Burglar Alarm Corp*., 106 Misc. 2d 559, 434 N.Y.S.2d 330 (Civil Court, Kings County 1980).
8. *West-Fair Electric Constructors v. Aetna Casualty & Surety Co*., 87 N.Y.2d 148, 638 N.Y.S.2d 394 (1995).
9. *Welsbach Electric Corp. v. MasTec North America, Inc*., 7 N.Y.3d 624, 859 N.E.2d 498 (2006).
10. N.Y. Gen. Bus. Law § 757(1).