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Contracting for Public Works Projects

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Many facets of contracting for public works projects are controlled by statute. However, as in any area of the law, in order to determine how the statutes are applied and how much latitude a public entity has in bidding, awarding and administering the performance of public works contracts, it is important to refer to the decisions and opinions of our courts. The purpose of this article is to not only review some of the more important cases in this area, but to discuss the practical, philosophical and legal issues involved in public construction projects from bid phase to project close-out.

I PUBLIC BIDDING

A. Project Specifications

Once the construction drawings and specifications are prepared, the project architect or engineer usually places an advertisement with the Dodge Reports or other publications to alert potential bidders so that they might pick up a copy of the plans and specifications and submit bids to perform the work.

The project specifications contain an "invitation to bidders" which establishes the legal framework upon which the bidder submits its bid. The municipal owner, as financial security, will require the bidder to submit a bid bond. Should the low bidder refuse to accept the award of the contract, the surety on the bid bond is liable for the difference between the bidder's bid and the next lowest bid, up to the penal sum of the bond. The bidder remains responsible for any shortfall. In addition, after the bidder returns the executed contract, it will be required to submit a performance bond and labor and material payment bond to the municipality (State Finance Law §137). The performance bond acts as security for the public owner in the event the contractor fails to complete its work. In such an event, the surety has various options and may hire a contractor to complete the work left undone by the defaulting contractor. If the contractor is not sufficiently progressing with its work, the owner may default the contractor. Determining whether or not to default a contractor is a very difficult decision for any municipal owner and should only be taken with the advice of counsel and after careful consideration of the economic implications.

The labor and material payment bond acts as financial security for entities that furnish labor and material to the project. A public owner should be alert to payment bond claims being made as it may be a symptom that the contractor is not timely paying its subcontractors and suppliers. Payment bond claims also may work to reduce the protection the owner is afforded by the performance bond. Most labor and material payment bonds and performance bonds have a joint penal sum so that if the surety pays a payment bond claimant, the penal sum of the performance bond is reduced so that less protection is available for the owner to secure the completion of the project should the contractor default.

B. Competitive Bidding Statutes

Municipal owners, with certain exceptions, must award contracts to the lowest responsible bidder. Public bidding in New York is governed, by and large, by General Municipal Law §103. The General Municipal Law requires that the public owner award the contract to the lowest responsible bidder. In order to be the lowest responsible bidder, however, the bidder's bid must be responsive. In other words, the bid must provide a price quote for every item for which the owner solicited a bid. If a bidder fails to submit a bid for a particular item of work, the bidder's bid should be deemed "non-responsive" by the municipality. As a non-responsive bidder, the bidder should not be awarded the contract. A contract that is awarded in violation of General Municipal Law §103 is void. Under such circumstances, the contractor would be performing its work at the risk of not having an enforceable legal right to be paid and the municipality would be faced with the risk of the next lowest responsible bidder seeking court intervention to review the conduct of the municipality in awarding the contract. The next lowest bidder would, no doubt, ask the court to issue a temporary restraining order preventing the work from proceeding until meaningful court review could occur.

A municipality may set forth in its request for bids certain minimum experience requirements for bidders on public contracts. For example, for a roofing project the municipality may require bidders to demonstrate that they have "in the last five (5) consecutive years prior to the bid opening," successfully completed in a "timely fashion at least two (2) roofing projects similar in type and scope to the work required" under the contract bid upon, which projects must be "completed and in service for a minimum of two (2) full [years]" prior to the bid opening. *P&C Giampilis Construction Corp. v. William J. Diamond,* 210 A.D.2d 64 (1st Dept., 1994). In *Giampilis*, the Court held that the City of New York was not only entitled to reject the low bid, since the low bidder failed to meet the experience requirements, it further determined that the municipality had a rational basis for rejecting the low bid, even though the individual principals of the corporate low bidder could demonstrate the requisite experience required by the bid documents. The courts of this state have repeatedly upheld the rejection by municipal agencies of competitive bids, without any further investigation other than a review of the bid documents, based on non-responsiveness, where the bids failed to "comply with the literal requirements of the bid specifications". *See LeCesse Bros. Contracting, Inc. v. The Town Board of the Town of Williamson*, 62 A.D.2d 28, 31 (1978), *aff'd* 46 N.Y.2d 960 (1979); *A.I. Smith of Long Island v. The City of Long Beach*, 158 A.D.2d 454 (2d Dept. 1990) [wherein the court upheld the City's rejection of a bid for failure to include a "detailed declaration of the bidders qualifications'' including the firm's experience]: *see also In re: Kaelber,* 281 A.D. 980 (2d Dept., 1953) and *W.J. Gaskell, Inc. v. Maslanka,* 33 Misc2d88 (Sup. Ct. Nassau Co., 1962).

However, a public owner can go too far in limiting the field of potential bidders. In the *Matter of Construction Contractors Association fo the Hudson Valley, Inc. v. Board of Trustees, Orange County Community College,* 192 A.D.2d 265 (2nd Dept., 1993), the Court held that a requirement in the bid specifications for restoration work on a historic building located at Orange County Community College violated public bidding statutes because it was too restrictive and unreasonably limited the potential pool of bidders. The requirement was that the contractor must have successfully completed two restoration projects on buildings listed on the National Register of Historic Places within the previous five years. While the Court held that the successful completion of similar projects is a reasonable requirement, there was no evidence before the Court that buildings registered on the National Register of Historic Places presented restoration problems unlike those of other historical buildings which are not so listed. Therefore, the Court concluded that such a flat

(Continued on page 2)

Public Works Contracts

(Continued from page 1)

requirement does not pass muster under General Municipal Law §103.

A "responsible" bidder is one that does not have a record that would adversely reflect on its honesty, trustworthiness or its ability to complete the project, including the requisite experience for the particular type of work involved. In determining whether or not a bidder is the lowest responsible bidder, the municipal entity is vested with a certain measure of discretion. Should the bidder not receive the award of a contract to which it felt itself entitled, the bidder would then have to bring a special court proceeding under Article 78 of New York's Civil Practice Law and Rules, seeking judicial review pursuant to which the court would determine whether the public entity "abused its discretion" or acted in an "arbitrary" or "capricious" manner. The Article 78 proceeding is typically commenced by way of an Order to Show Cause seeking a temporary restraining order preventing the work from proceeding until judicial review is concluded.

The standard of review of an agency's decision to award or deny a contract is whether there is a rational basis to support that determination, and the burden of proving that there is no rational basis for the decision is on the contractor. *See Matter of Schiavone Construction Co., Inc. v. LaRocca,* 117 A.D.2d 440, 444, lv. *denied* 68 N.Y.2d 610 (1986).

The courts have also recognized, however, that when a low bidder has its bid rejected with the inevitable implication of non-responsibility, its "commercial good name, reputation, honor, or integrity" is at stake. *See LaCorte Electrical Construction and Maintenance, Inc. v. County of Rensselaer*, 80 N.Y.2d 232 (1992) citing *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972) *and Wisconsin v. Constantineau*, 400 U.S. 433 (1971). While safeguards of reasonable notice and timely opportunity to be heard become operative in such circumstances, the public fisc and process must also be weighed in light of the additional expense of a more costly contract flowing from the rejection of the lowest bid. In considering the required and appropriate remedies for failure to afford necessary protections, courts are not blind to the need that governmental agencies be able to conduct business in an efficient and effective manner and to the potentially crippling effect that might result from the imposition of stringent due process requirements with respect to all government actions adverse to unsuccessful bidders on Government contracts. *See, LaCorte, supra.* While a low bidder does not acquire a property right in a contract, it has been held that a low bidder does have a "liberty" interest which includes the right to contract. *Id.* As a result, there are certain minimal due process requirements which the municipality must meet when making a determination that a contractor is not a "responsible bidder". Giving the bidder notice of a municipality's concern over its responsibility and the reasons for that concern, and affording the bidder the opportunity to rebut the charges both in writing and at informal hearings, have been determined to meet the minimal due process requirements, especially in light of the availability of court review pursuant to CPLR Article 78. *See Matter of Schiavone Construction Co. v. LaRocca., supra.* It is important to note that in reaching a determination of non-responsibility, it is not necessary for the municipality or agency to have an evidentiary hearing, as long as there is an opportunity for the low bidder to be heard, whether at a meeting or in the form of written submissions. *See Tully Construction Co., Inc., v. Hevesi,* 214 A.D.2d 465 (1st Dept., 1995).

The public owner, in determining which bidder is the lowest responsible bidder, should verify the bidder's references to make sure that the bidder is "responsible". The owner should also review the bid with the bidder to make sure that the bidder has a complete understanding of the scope of work to be performed.

Municipal owners should also be wary of prime contractors acting as brokers and not actually performing any work activities themselves. In order to guard against this risk, the contract should have a limitation on the dollar value that can be subcontracted. Certain public entities also establish Minority and Women owned Business Enterprise ("MBE" and "WBE") goals that are typically met by subcontracting certain aspects of work.

Upon determination of the apparent lowest responsive and responsible bidder and prior to award, the municipality or agency may elect to open negotiations with the selected bidder in an effort to improve the bid to the municipality or agency with respect to the price only. In *Matter of Fischbach & Moore v. New York City Transit Auth.*, 79 A.D.2d 14 (2nd Dept., 1981) *lv. denied* 53 N.Y.2d 604 (1981), the court held that once the bidding process fairly produces a lowest responsible bidder, there is no supervening interest or policy consideration which precludes a municipality or agency from negotiating and obtaining a postbid, pre-award price concession from that very same bidder. However, the court cautioned that a municipality may *not* "engage in postbid negotiations through which a contractor other than the low bidder may become the low bidder," or coerce a low bidder to making unfair and unwarranted concessions through the threat of rejecting all bids. In the event the apparent lowest responsive and responsible bidder declines to negotiate, the municipality may elect to either award the contract to the apparent lowest responsive and responsible bidder or may, upon reasonable grounds, reject all bids in accordance with General Municipal Law §103. *See also, Acme Bus Corp. v. Board of Education of the Roosevelt Union Free School District*, 91 N.Y.2d 51 (1997).

It is important to recognize that the laws requiring competitive bidding were designed to benefit taxpayers rather than a particular bidder, and thus should be "construed and administered with sole reference to the public interest". *Id.* In *Matter of New York State Ch., Inc., Associated Gen. Contrs. of America v. New York State Thruway Auth.*, 88 N.Y.2d 56 (1996), the New York Court of Appeals declared that there are "two central purposes of New York's competitive bidding statutes, both falling under the rubric of promoting the public interest: (1) protection of the public fisc by obtaining the best work at the lowest possible price; and (2) prevention of favoritism, improvidence, fraud and corruption in the awarding of public contracts."

In *Acme Bus Corp., supra,* the court stated that these separate goals are not incompatible. Favoritism or irregularity in the bidding process may ostensibly produce monetary savings, but the use of such means to meet that singular end is still unsustainable because the complete public interest is ultimately promoted by fostering honest competition. The spectral appearance, however, of impropriety is insufficient proof to disturb a board's determination under the competitive bidding statutes. An unsuccessful bidder has the burden to demonstrate "actual" impropriety, unfair dealing or some other violation of statutory requirements when challenging an award of a public contract. *See Matter of Conduit & Found. Corp. v. Metropolitan Transp. Auth.*, 66 N.Y.2d 144 (1985).

A public owner issues an award of contract to the bidder it deems to be the lowest responsible bidder and then issues a "Notice of Award" and ultimately a "Notice to Proceed" when the work is ready to commence. Upon the bidder's receipt of the Notice of Award, the bidder will be required to return the executed contract and forward the appropriate bonds and insurance certificates. After the owner receives and reviews the executed contract and makes sure that the necessary bonds and insurances have been provided, the owner will then issue a Notice to Proceed directing the bidder, now contractor, to start work.

C. Bid Mistakes

On occasion, a bidder may submit a bid that is disproportionately low when compared with the owner's estimate of the costs, or the bids submitted by other bidders. In such a case, the owner may be on notice that the bidder has made a mistake. The bidder may also realize that it made a mistake and seek to withdraw its bid. The public owner when faced with deciding whether or not to permit a bidder to withdraw its bid, must act with a high degree of caution as the municipality, bidder and its surety, as well as the next lowest bidder, all have a financial stake in the decision. In order for a municipal owner to legally accept the withdrawal of a bid based on a unilateral mistake, it must first receive a notice from the bidder within three days of the bid opening

(Continued on page 3)

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Public Works Contracts

(Continued from page 2)

requesting the withdrawal of its bid. General Municipal Law §103 (11)(a), states as follows:

"11. Bid mistakes; public projects. (a) In all contracts governed by this section, where a unilateral error or mistake is discovered in a bid, such bid may be withdrawn after a showing of the following: (1) the mistake is known or made known to the awarding officer, board or agency prior to the awarding of the contract or within three days after the opening of the bid, whichever period is shorter; and (2) the price bid was based on an error of such magnitude that enforcement would be unconscionable; and (3) the bid was submitted in good faith and the bidder submits credible evidence that the mistake was a clerical error as opposed to a judgment error; and (4) the error in the bid is actually due to an unintentional and substantial arithmetic error or an unintentional omission of a substantial quantity of work, labor, material, goods or services made directly in the compilation of the bid, which unintentional arithmetic error or unintentional omission can be clearly shown by objective evidence drawn from inspection of the original work paper, documents, or materials used in the preparation of the bid sought to be withdrawn; and (5) it is possible to place the public agency, board, officer, or subdivision in status quo ante."

Upon the owner's receipt of such a letter from a bidder, the owner should carefully review the supporting documentation to make sure that the error was a clerical error and not an error in judgment. An error in judgment is not a sufficient basis for accepting the withdrawal of a bid.

For example, an agency's refusal to permit a contractor to withdraw its bid was found not to be arbitrary or capricious where shortly after the bid was accepted, the contractor notified the agency that it had made an error, but delayed three months before requesting to be released from its bid. *Gilston Elec. Contracting Corp. v. Popolizio* 169 A.D.2d 583 (1st Dept., 1991). In *Balaban-Gordon Co. v. Brighton Sewer Dist. No. 2*, 67 Misc.2d 76 (Sup. Ct., Monroe Co. 1971), a contractor prepared a bid for general construction for a sewage treatment plant, and also a bid for the plumbing and equipment for such plants. In doing so, the contractor misinterpreted the specifications and erroneously omitted certain items that had to be furnished under the general construction contract and instead included these items in computations it made in preparing its bid for the plumbing contract. Given that the contractor gave the sewer district notice of its mistake the day after bids were opened, the court held that the district could not properly retain advantage of the contractor's mistake, and fair dealing required that contractor be relieved of its bid.

II CONTRACT PERFORMANCE AND CLAIMS

A. Role of Project Architect as Owner's Representative

After the award of the contract and Notice to Proceed is issued, the architect or consulting engineer will typically act as the owner's representative during the course of construction. The owner's representative will coordinate the kick-off meeting and schedule weekly progress meetings or such other meetings as are necessary to monitor the work performed by the contractors. The owner's representative does not insure the quality of the work, but instead acts as the owner's eyes and ears to make sure that the work is being performed in accordance with the contract specifications.

The main role served by the owner's representative is to certify what payments are properly due and owing to the contractors. Contractors typically submit requisitions for payment on a monthly basis whereupon the owner's representative reviews the requisition with the contractor at the project site to determine what percentage of completion was achieved by the contractor. The contract is typically divided into items of work so that the contractor submits a "schedule of values" for each item of work. After the owner issues a Notice of Award, the owner's representative and the bidder will agree upon what values should be attributed to each item of work and a schedule of values is prepared.

Some contracts are awarded on a lump sum basis while others are on a unit price basis depending on the nature of the work involved. Regardless of the manner in which the contractor is to be compensated, the owner's representative will monitor the level of completion and certify what payments are due.

B. Interpretation of Contract

The owner's representative, during construction, typically acts as the first interpreter of contractual disputes. Accordingly, if a contractor submits a request for a change order seeking additional money for certain work, the owner's representative will review the plans and specifications and make a recommendation to the owner as to whether or not a change order should be issued. An owner should be careful to document any disagreements it may have with its architect concerning whether or not any item of given work is additional work, because the contractor could, in a subsequent lawsuit, claim that the architect was not exhibiting independent professional judgment or that the owner and the architect conspired to deprive the contractor of its working capital.

C. Presentation of Claims

The owner's representative, in addition to making various determinations as to whether or not a contractor is entitled to be issued a change order for additional work, must also determine whether a contractor should be granted an extension of time to perform any additional work or in order to compensate the contractor for unanticipated delays it encountered in performing its work. The owner should be careful in this area and should seek legal counsel as disclaimers may or may not protect the owner depending on the circumstances. Early resolution of a contractor's claim will, in the long run, limit the owner's costs.

Certain disclaimers and other legal clauses can protect a municipality from liability depending on the circumstances. For example, to avoid responsibility for incorrect or incomplete information, bid documents often include disclaimer clauses, which generally require the contractor to investigate the project site and determine the risks associated with building the project. The owner also typically disclaims responsibility for the information it provides and states that such information is provided for estimating purposes only. An effective disclaimer prevents the contractor from claiming that it reasonably relied on the accuracy of certain bid information and requires the contractor to make its own investigations. Disclaimer clauses, however, are strictly construed against owners.

Changed conditions clauses are also often used in municipal contracts. Such a clause provides for procedures for identifying changed conditions and modifying the contract if additional work is necessary due to unanticipated conditions. An example of such a clause follows:

"Viewing of Site and Consideration of Other Sources of Information (b) Changed Conditions - Should the contractor encounter during the progress of the work, subsurface conditions at the site materially differing from any shown on the Contract Drawings or indicated in the specifications or such subsurface conditions as could not reasonably have been anticipated by the contractor and were not anticipated by the City, which conditions will materially effect the cost of the work to be done on the contract, the attention of the Commissioner must be called immediately to such conditions before they are disturbed. The Commissioner shall thereupon promptly investigate the conditions. If he finds [a changed condition]. . . the contract may be modified . . .(*Andrew Catapano Co. v. City of New York*, 116 Misc.2d 163 (S. Ct. N.Y. Co., 1980).

A common exculpatory clause found in municipal contracts is what is known as the "No Damage for Delay" clause. Such a clause attempts to excuse an owner from contractual liability for monetary damages due to delays caused by itself, its architect and/or engineer and other entities under its employ. While "no damage for delay" clauses are generally valid and enforceable in New York, the courts have carved out certain exceptions. *See Corinno Civetta Construction Corp. v. City of New York*, 67 N.Y.2d 297 (1986). Generally, even with such a clause, the contractor may recover damages for: (1) delays caused by the owner's bad faith or its willful, malicious, or grossly negligent conduct; (2) uncontemplated delays; (3) delays so unreasonable that they constitute an intentional abandonment of the contract by the owner; and (4) delays resulting from the owner's breach of a fundamental obligation of the contract. *Id.*

In a recent case, the Appellate Division, Third Department held that a contractor on a school renovation project was entitled to recover delay damages against the school district even though the public contract contained a "no damage for delay" clause. *See, Clifford R. Gray, Inc. v. City School District of Albany*, 716 N.Y.S.2d 795 [2000]. The Court found that: (i) the evidence was sufficient to support a determination that the delays were uncontemplated; and (ii) the school district was responsible for the breach of fundamental contractual obligations, permitting

(Continued on page 4)

Public Works Contracts

(Continued from page 3)

the contractor to recover its delay damages despite the contract's exculpatory clause.

Contract clauses containing strict notice and reporting provisions can also be extremely beneficial to a municipality. In *A.H.A. General Construction, Inc. v. New York City Housing Authority,* 92 N.Y.2d 20 (1998), the Court found that a contractor's failure to strictly comply with the contract's notice and reporting provisions barred it from recovering for extra work. The subject contract required that in the event the owner determines that the work being performed is not extra work, the contractor must notify the owner within five days that the work is being performed "under protest", or else the claim for extra work is waived. The contract also required that a contractor claiming damages resulting from an act or omission of the owner is required to give notice within five (5) days of the act or omission, and provide detailed statements and proof of damages within thirty (30) days, or the claim would also be waived. Under another section of the contract, a contractor performing extra work or disputed work is required to furnish daily statements to the public owner during the performance of that work, including the name and number of workmen employed on the work; the number of hours employed; the character of the work and the nature and quantity of any material or equipment used. In *A.H.A. General Construction, Inc., supra,* the Court determined that although the contractor performed the extra work, the contractor failed to abide by the notice provisions, and, therefore, its claims for extra work were waived. The Court stated that the notice and reporting provisions of the contract were "conditions precedent" to suit for recovery for the extra work, and not "exculpatory clauses" (exculpatory clauses like "no damage for delay" clauses are meant to absolve or exculpate the owner from liability for its acts or omissions). Therefore, claims by the contractor that the owner committed bad faith or was negligent in the performance of the contract were irrelevant unless the contractor was able to show that the misconduct prevented or hindered the contractor's compliance with the notice and reporting requirements. The notice requirements contained in a contract can be adhered to by the contractor regardless of the progress of the actual construction work.

Additional concerns that the public owner faces during the construction phase are claims that the plans and specifications were not capable of performance as originally drawn. Here, the owner's representative, if it is the same architect that designed the project, is typically reluctant to issue any change orders based on claimed design errors or omissions as to do so would, in effect, be an admission that the architect failed to adhere to professional standards.

The owner's representative should also assist the municipality by being alert to concerns raised by subcontractors and suppliers that have not been timely paid by the contractor. A contractor that fails to pay its subcontractors and suppliers may lack the financial resources to complete the project and may be diverting construction funds generated on the subject project to another project. The owner's representative can protect the owner's interest by limiting its certification of moneys due the contractor by instructing the owner to withhold moneys based on the filing of mechanic's liens or known claims of subcontractors and suppliers. The owner's representative may also request that Waivers of Lien be tendered by the subcontractors and suppliers.

D. Default and/or Termination

On occasion, the owner's representative may be so dissatisfied with a contractor's performance that it recommends to the owner that the contractor be terminated. In order for the contractor to be properly terminated, it must be afforded certain due process rights as the contractor is entitled to an opportunity to be heard with respect to the default. The owner will also make sure that the contractor's surety is provided with notice of the default, etc. as the owner will be looking to the surety to complete the project. At the point where a contractor may face termination, the owner must carefully consider the legal and economic implications as the owner may be deemed by a court, in a subsequent lawsuit, to have wrongfully terminated the contractor.

Alternate dispute resolution should be considered by the municipality. Mediation and arbitration are two methods of dispute resolution. Public owners do not favor arbitration or mediation because of the perception that the results tend to be a compromise as opposed to a strict legal reading of the contract which was prepared by the owner and contains, or should contain, every conceivable disclaimer, etc. in favor of the municipality. Courts also tend to strictly enforce municipal contracts in favor of municipal owners and against the contractor. An additional reason why a public owner may not wish to have an arbitration or mediation provision in its contract, is that the economic burden that a contractor would face in pursuing a recovery against a public owner in the court system could itself act as an economic deterrent to commencing or continuing a lawsuit. The cost avoidance factor can be used by a municipality in negotiating a settlement with the contractor.

However, some municipalities have availed themselves of dispute resolution procedures which vest authority to decide disputes such as claims by contractors for extra work in an employee or designee (sometimes, even a contract dispute resolution board) of the municipality. While such dispute resolution procedures appear to be unfair, the New York Court of Appeals has repeatedly held that they are not violative of any public policy concerning the fair adjudication of such disputes, provided there is some independent review mechanism sufficient to satisfy minimum review standards such as those contained in CPLR Articles 75 or 78. *See Westinghouse Electric Corp. v. New York City Transit Authority*, 82 N.Y.2d 47 (1993).

E. Beneficial Use and Occupancy

After the contractor has achieved substantial completion, the architect will issue a Certificate of Substantial Completion indicating that the project is fit for its intended purposes and/or beneficial use or occupancy. At the point of substantial completion, the owner's representative will typically issue a "punch list" which details the outstanding items of work to be completed by the contractor. The punch list will also identify items of work that were performed incorrectly but which must be corrected in order for the contractor to receive its final payment. After the contractor completes its work, the project should be accepted and a "Certificate of Acceptance" or similar document may be issued.

Prior to making final payment to the contractor, the owner should satisfy itself that it has obtained all necessary Releases and Affidavits of Payment of Debts and Claims from the various prime contractors indicating that they paid their subcontractors and suppliers, in full, for all job related debts. In addition, the prime contractors should furnish the owner with Lien Waivers and a "Consent of Surety" indicating that the prime contractor's surety has no interest in the retained funds. All appropriate warranties from the contractor should also be secured by the owner's representative prior to final payment being made.

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