BRACH EICHLER LLC
Counsellors at Law

Litigation Quarterly Advisor

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In This Issue:

Combatting Material and Labor Increases with Contract Escalator Clauses

Over the last year, the COVID-19 pandemic has wreaked havoc on fixed-price contracts that rely on the price of raw materials. For example, the pharmaceutical industry has seen a drastic shortage in the production of glass vials—the very vials used to store the COVID-19 vaccine. These shortages, resulting in unprecedented price increases, affect suppliers, manufacturers, distributors, and contractors (just to name a few) who are required to produce, distribute, or deliver a final product. So how do price fluctuations affect contract obligations and the ability to perform under a contract when prices of materials or labor have unexpectedly soared? The answer depends on your agreement. And now, due to the volatility in the marketplace, it is the best time to review your company's contracts and vendor contracts.

Indeed, many are mistakenly under the impression that if the cost of performance becomes too high to bear—the company can escape its contractual obligations under a *force majeure* provision or the common law doctrines of frustration of purpose and commercial impracticality. But these doctrines do not always provide protection. See generally, *Tilcon New York, Inc. v. Morris Cty. Co-op. Pricing Council*, 2014 WL 839122, at *17-21 (N.J. Super. Ct. App. Div. Mar. 5, 2014) (finding contractors were not entitled to relief under the doctrines of frustration of purpose and impracticability of performance). Courts are unlikely to relieve a party of its contractual obligations under an agreement that sets forth a "fixed-price" because one party ultimately agreed to assume the risk of material escalation. See Id., *17-21.

So, how can a business protect itself, and its profit margins, in this volatile marketplace? The inclusion of an "escalator clause" in your contract, a clause allowing for an increase in the price of a contract upon the occurrence of certain defined events, may provide some protection. Parties can craft the escalator clause in advance, therefore escalator clauses are a more predictable way for a company to protect itself against price increases rather than *force majeure* provisions.

An escalator clause can protect your company from unexpected price increases, due to factors beyond the control of either party. Without an escalator clause, even though the parties didn't anticipate the increase, only one party may be forced to bear the risk.

There are generally two types of escalator clauses: (i) "cost-based" and (ii) "indexed based." A "cost-based" escalation provision contrasts the actual cost incurred by the supplier / manufacturer/contractor with the stated amount in the parties' agreement (bid/estimate). An "index based" provision tracks material prices based on indexes, e.g., the Producer Price Index.

Now is the time to be proactive rather than reactive. Legal counsel is necessary to review contracts to ensure that necessary provisions are included to protect your company. Brach Eichler is available to review your company's contracts to ensure that your company is protected, as well as provide guidance on the appropriate escalation clause that meets your company's needs.

For more information, contact:

Rose Suriano | 973.403.3129 | rsuriano@bracheichler.com
Matthew M. Collins | 973.403.3151 | mcollins@bracheichler.com

The "Liquidated Damages" Clause – What Is It And How It Can Reduce Litigation

A "Liquidated Damages" clause in your next contract can be a powerful tool to set a pre-determined damages amount in case of breach by the other party and to avoid costly, time-draining litigation. Using a "liquidated damages" clause effectively requires an understanding of what "liquidated damages" are to avoid a court ruling that the clause is a "penalty."

"Liquidated damages" are a specific, predetermined amount that contracting parties agree will be the damages paid in the event of a breach because the calculation of damages is difficult to prove.

Because "liquidated damages" provisions in contracts save time for courts, jurists, parties, and witnesses, as well as

reduce the expense of litigation, New Jersey (and most other state and federal) courts, consider "liquidated damages" provisions presumptively valid as long as the amount is fixed and the damages amount is reasonable in light of the harm caused by the breach. Courts will not enforce damages provisions that are so large as to result in a penalty, as penalty clauses are not enforceable in New Jersey (and most states).

Liquidated damages clauses are not enforceable unless: (1) the fixed amount is a reasonable forecast of just compensation for the harm; and (2) the harm caused by the breach is difficult to estimate accurately. The more uncertain the damages caused by the breach; the more latitude courts give on the estimate. If it is doubtful whether the provision for payment is intended as a penalty or liquidated damages, it will be construed as a penalty.

Therefore, a "liquidated damages" clause in your next contract could be an effective tool to not only solve the headache of a potential breach but also an ideal way to avoid the expensive and time-consuming litigation process, especially where the damage caused by a breach is hard to calculate or difficult to prove.

For more information, contact:

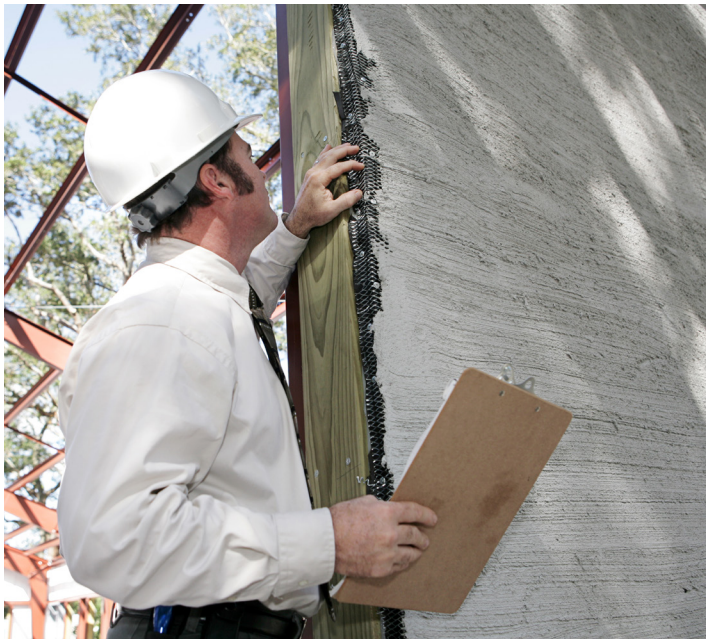
Bob Kasolas | 973.403.3139 | bkasolas@bracheichler.com
Riza I. Dagli | 973.403.3103 | rdagli@bracheichler.com

Indemnity Provisions - How Can They Allocate Risk to Another Party

An indemnity provision, sometimes referred to as a "hold harmless" clause, is used in contracts to shift potential costs from one party to the other, and is an important clause to control the risk of loss. This creates a legal obligation whereby one party (called the "Indemnitor") holds the other party (called the "Indemnitee") harmless for its conduct, or another person's conduct. Indemnity provisions can relieve the indemnitee of liability for certain claims asserted against it, or it can require the indemnitor to be financially responsible for certain claims asserted against the indemnitee. These provisions can take many different forms, and the potential liability or losses covered under each depend entirely on the specific language used in the agreement.

Indemnification provisions are generally enforceable and appear in many types of agreements. Indemnity provisions are quite common in construction contracts and subcontracts. New Jersey law recognizes the right of an indemnitee to obtain indemnification for their negligence in the context of construction contracts. But there are exceptions. Specifically, N.J.S.A. 2A:40A-1, prohibits the contractual imposition of indemnity upon a party to a construction project contract for the sole negligence of another party. Any attempt in a contract to provide indemnification for another's sole negligence is against public policy and will be rendered unenforceable.

In some circumstances, courts have commonly held that a plaintiff may not recover damages under an indemnity clause to the extent that the damages are an unforeseeable outcome of the other party's breach, negligence, or misconduct (unless it can be shown that the indemnifying party knew the relevant circumstances). Indemnifications should always be drafted clearly, as ambiguity is most often resolved by courts in favor of the indemnifying party. They should be broad enough to sufficiently address the parties' concerns, yet reasonable and equitable in all respects so that their enforceability is not called into question.



Taking the time to sufficiently review the indemnification provision in each contract with a legal team will help protect you against risk and loss to your company. By making sure an indemnity provision is included in your contract it may protect you against unexpected liability.

For more information, contact:

Keith J. Roberts | 973.364.5201 | kroberts@bracheichler.com
Kelley Rutkowski | 973.364.5215 | krutkowski@bracheichler.com

NEED TO KNOW

Key Highlights That Could Impact Your Business Litigations

Jury Trial Update:

Member Relationships Within A Limited Liability Company – A recent New Jersey case will be of interest to business owners who operate in the form of a limited liability company ("LLC"). The case addresses the rights of one member, of a two member LLC, to recover damages from the co-member, who was liable

for breach of fiduciary duty, theft, conversion, and fraud for surreptitiously selling property of the LLC without sharing the proceeds with the plaintiff, the other 50 percent member.

The recent case of *Sayegh v. Kalaba*, 2021 WL 2879128 (App. Div. 2021), involved a two equal member, LLC. The defendant, Kalaba was alleged to have unilaterally sold LLC property without consulting his co-member, the plaintiff. The plaintiff also alleged that the defendant, simply pocketed the proceeds of the sale. After the trial, judgment for compensatory damages was awarded to the plaintiff, but since the trial court denied his claim for punitive damages, he appealed.

On appeal, defendant, Kabala argued that under the Revised Uniform Limited Liability Company Act, only a derivative action could enforce a right of the LLC, and the plaintiff's claims were derivative claims. The court ruled that because the co-member was the only person harmed and had suffered an injury unique to him, the special injury exception to the derivative action requirement applied.

The evidence and trial court's findings of wrongdoing clearly and convincingly demonstrated Kalaba's egregious conduct, his deceitful transfer of LLC assets to only benefit only him, as being a deliberate act with knowledge of harm to his "partner" and with reckless indifference to the consequences. Upon this basis, the Appellate Division remanded the matter to the Trial Court for a determination of the number of punitive damages to the plaintiff.

This case highlights the importance of keeping the assets and the property of an LLC separate from an individual member's assets. A member of an LLC has a fiduciary duty to treat the property of the LLC as such, and not as personal property. Failing to do so could subject a member not only to significant monetary damages, it may subject the member to an award of punitive damages.

For more information, contact:

Stuart L. Pachman | 973.403.3133 | spachman@bracheichler.com
Charles X. Gormally | 973.403.3111 | cgormally@bracheichler.com
Autumn M. McCourt | 973.403.3104 | amccourt@bracheichler.com

Relief for Landlords Who Obtained an Order of Eviction Pre-Covid but Were Unable to Serve the Warrant of Removal Before Its Expiration – Once a landlord obtains a judgment for possession from the Court, a warrant of removal must be executed within 30 days of its issuance to effectuate the removal of the tenant. During the COVID-19 pandemic many warrants of removal were not served within the 30 days, thus expiring. The New Jersey Supreme Court has issued an order relaxing the 30-day rule and permitting a one-time reissuance of such expired warrants of removal upon submission of a letter to the Court requesting the same. All requests for reissuance must be filed by December 31, 2021, and notice must be provided to the tenant.

For additional information, please or contact:

Stuart J. Polkowitz | 973.403.3152 | spolkowitz@bracheichler.com

Contractors Need to Take Note of the Strength of the Prompt Payment Act – In recent years, the Prompt Payment Act and its attorney's fees provisions have been scoffed at by non-paying contractors. However, courts are now enforcing the Act and non-paying contractors should take note. Recently, the Trial Court, after a two-day trial, ruled against a non-paying contractor, finding that it violated the Prompt Payment Act, the Trial Court awarded the subcontractor a small portion of its attorney's fees and costs incurred in bringing a claim against the general contractor, a portion that the Court found was proportional to the claim. However, the Appellate Division disagreed with the limitation on the number of attorney's fees and costs awarded and found that proportionality does not apply to an award of attorney's fees under the Prompt Payment Act. The Appellate Division remanded the case so that the trial court could evaluate the full amount of legal fees and costs incurred by the subcontractor in bringing the claim. This Appellate Division's analysis and refusal to limit the award of legal fees should give contractors pause in withholding payments, without documented justification.

For additional information, please contact:

Anthony M. Rainone | 973.364.8372 | arainone@bracheichler.com
Autumn M. McCourt | 973.403.3104 | amccourt@bracheichler.com

Subcontractors Beware – A Contractor's Bankruptcy May Jeopardize Your Construction Lien – The New Jersey Construction Lien Law ("CLL") provides contractors, subcontractors, and suppliers who provide work, labor, and materials on a private construction project under a written contract with the right to file a lien against the real property on which the labor and improvements were constructed.

Where the bankrupt party is a general contractor, Bankruptcy Courts will view the filing of a construction lien on the real property of a non-debtor property owner as a violation of the automatic stay imposed under Section 362 of the Bankruptcy Code, as the lien would necessarily attach to the debtor's accounts receivable due from the property owner. But what happens when the subcontractor diligently records its construction lien before the bankruptcy as required under the New Jersey CLL?

In re: Katerra, Inc., 21-31861, the debtor-general contractor has asked the Bankruptcy Court for the Southern District of Texas to rule that these pre-petition construction liens filed under New Jersey's construction lien law "may only be asserted against the construction project owner," even if the debtor-general contractor pursues the project owner for unpaid accounts receivable. Such a result, at first glance, appears to contravene New Jersey's CLL, which is designed to protect subcontractors and suppliers of a construction lien project and owners "against paying more than once for the same work or materials." *L&W Supply Corp. v. DeSilva*, 429 N.J. Super. 179, 184 (App. Div. 2012).

It appears a Bankruptcy Court will be asked to affirmatively rule on whether a validly perfected pre-petition lien attaches

to a debtor's accounts receivable and constitutes a secured claim against a debtor-general contractor's bankruptcy estate. A hearing before the Bankruptcy Court is tentatively scheduled for October 20, 2021. Stay tuned for the Bankruptcy Court's ruling to impact how subcontractors and suppliers can protect their claims under State Law for years to come.

For additional information, please or contact:

Carl J. Soranno | 973.403.3127 | csoranno@bracheichler.com
Frances B. Stella | 973.403.3149 | fstella@bracheichler.com

WINS AND SIGNIFICANT BRACH EICHLER LITIGATION DEVELOPMENTS

Anthony Rainone and **Autumn McCourt** successfully represented a subcontractor against a contractor for non-payment, achieving complete success for the contractor's breach of contract and violation of the Prompt Payment Act, but the trial court failed to award the significant attorneys' fees and costs incurred by the subcontractor as a result of the contractor's litigation posture claiming it could not award more in attorneys' fees and cost than the amount at issue. On appeal, in a published decision, the court reversed the trial court's paltry fees and costs award and directed the trial court to re-do the award of fees and costs recognizing the complete success of the subcontractor on its claims and that there is no proportionality required between the judgment amount and the fees and costs award under the Prompt Payment Act.

Anthony Rainone and **Eric Magnelli** successfully represented a well-known concrete/masonry contractor from Essex County before the Occupational Safety and Health Review Commission. Our client was cited by OSHA for a regulatory violation due to an injury at a construction site in Jersey City. In February 2019, a two-day trial was conducted before an Administrative Law Judge who found in favor of OSHA on the violation. On appeal to the Federal Occupational Safety and Health Review Commission for discretionary review (the level before the 3d Circuit Court of Appeals), the panel unanimously reversed the ALJ's ruling for OSHA and vacated the citation/violation.

Keith Roberts and **Lauren Woods** defended a client in a discrimination and wrongful termination case. The former employee was alleging that he had been wrongfully terminated and discriminated against because of his past drug addiction (which he told his employer about) and his COVID-19 diagnosis. We filed a motion to partially dismiss the LAD and CEPA claims (both against the employer and individual managers) and in the alternative to compel arbitration in Florida. The Court granted our motion entirely and referred the matter to arbitration. As of now, the plaintiff has not sought arbitration.

ATTORNEY SPOTLIGHT

Get to know the faces and stories of the people behind the articles in each issue. This month, we invite you to meet Member **Stuart Polkowitz** and Counsel **Thomas Kamvosoulis.**

Stuart Polkowitz

Stuart Polkowitz handles matters encompassing all phases of litigation and arbitration. In particular, he focuses on general commercial, real estate, complex construction, healthcare and insurance litigation. He also counsels insurance companies on run-off operations and strategies. Stuart also serves as outside counsel to group dental practices and dental support organizations, handling a broad scope of contract relations, employment, and corporate matters.

On the weekends, Stuart looks forward to attending Yankees games, trying a new restaurant, and spending time with his family.

Thomas Kamvosoulis

Thomas Kamvosoulis focuses his practice on complex corporate litigation, where he represents closely-held companies in a broad range of matters including shareholder divorces, partnership dissolutions, minority oppression cases, restrictive covenant enforcement, trade secrets, securities fraud, and an assortment of contract disputes. Tom also counsels clients on a variety of employment issues, including claims of discrimination, harassment, whistle-blowing, and compliance with state and federal wage and hour laws.

In his spare time, Thomas enjoys runs on the beach, live music, and art museums, as well as traveling with his wife and daughter.

Brach Eichler Litigation *In The News*

On September 14, a team of Brach Eichler attorneys and paralegals volunteered at 420NJEvents' Expungement Clinic and provided pro-bono legal services to assist with the expungement process for non-violent cannabis convictions.

On September 15, **Brach Eichler** was spotlighted for being named ***New Jersey Law Journal's* 2021 Healthcare Litigation Department of the Year**.

On August 19, 17 Brach Eichler attorneys were included in The Best Lawyers in America© 2022 and six attorneys were named to "Ones to Watch."

On September 24, **Rose Suriano**, Member and Co-Chair Litigation was named a 2021 Best 50 Women in Business Honoree by *NJBIZ*.

On August 26, Labor and Employment Co-Chair **Matthew Collins** writes in the *New Jersey Law Journal* about how "Today's Water Cooler Talk About Current Events Can Lead to Tomorrow's Legal Headache."

Brach Eichler welcomes two new litigation associates: **Eric Alvarez** and **Rebecca Kinburn**. Eric focuses his practice on complex commercial disputes. Rebecca has considerable experience in complex business litigation, including a broad range of matters in court, arbitration and administrative proceedings, including bankruptcy, securities litigation, patent litigation, white collar representation, and general commercial litigation.

Closing Remarks

As we all know, the pandemic has effected every business in some way. The topics addressed in this Newsletter highlight the importance of having a contract that protects your company from unknown and unforeseen events, post-contract. Consulting with Brach Eichler at the contract negotiation stage will ensure that your company is protected.

A special thanks to Autumn McCourt as the Fall Litigation Quarterly Advisor editor.

BRACH EICHLER LLC
Counsellors at Law

Litigation Practice | 101 Eisenhower Parkway, Roseland, NJ 07068

Co-Chairs

Keith J. Roberts | 973.364.5201 | kroberts@bracheichler.com
Rose Suriano | 973.403.3129 | rsuriano@bracheichler.com

Members

Matthew M. Collins | 973.403.3151 | mcollins@bracheichler.com
Riza I. Dagli | 973.403.3103 | rdagli@bracheichler.com
Charles X. Gormally | 973.403.3111 | cgormally@bracheichler.com
Bob Kasolas | 973.403.3139 | bkasolas@bracheichler.com
Stuart J. Polkowitz | 973.403.3152 | spolkowitz@bracheichler.com
Anthony M. Rainone | 973.364.8372 | arainone@bracheichler.com
Carl J. Soranno | 973.403.3127 | csoranno@bracheichler.com
Frances B. Stella | 973.403.3149 | fstella@bracheichler.com

Counsel

Colleen Buontempo | 973.364.5210 | cbuontempo@bracheichler.com
Shannon Carroll | 973.403.3126 | scarroll@bracheichler.com
Anthony M. Juliano | 973.403.3154 | ajuliano@bracheichler.com
Thomas Kamvosoulis | 973.403.3130 | tkamvosoulis@bracheichler.com
Eric Magnelli | 973.403.3110 | emagnelli@bracheichler.com
Sean Alden Smith | 973.364.5216 | sasmith@bracheichler.com
Thomas J. Spies | 973.364.5235 | tspies@bracheichler.com

Associates

Eric Alvarez | 973.364.8330 | ealvarez@bracheichler.com
Lindsay P. Cambron | 973.364.5232 | lcambron@bracheichler.com
Mark E. Critchley | 973.364.8339 | mcritchley@bracheichler.com
Paul J. DeMartino, Jr. | 973.364.5228 | pdemartino@bracheichler.com
Emily J. Harris | 973.364.5205 | eharris@bracheichler.com
Rebecca Kinburn | 973.364.5208 | rkinburn@bracheichler.com
Angelo Langadakis III | 973.364.8359 | alangadakis@bracheichler.com
Robyn K. Lym | 973.403.3124 | rlym@bracheichler.com
Autumn M. McCourt | 973.403.3104 | amccourt@bracheichler.com
Michael A. Rienzi | 973.364.5226 | mrienzi@bracheichler.com
Kelley M. Rutkowski | 973.364.5215 | krutkowski@bracheichler.com
Michael A. Spizzuco, Jr. | 973.364.8342 | mspizzuco@bracheichler.com
Lauren Adornetto Woods | 973.364.5211 | lwoods@bracheichler.com

Roseland, NJ | New York, NY | West Palm Beach, FL | www.bracheichler.com | 973.228.5700

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