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CONSTRUCTION LEGAL EDGE

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ARTICLES CONTAINED IN THIS ISSUE OF THE CLE:

An Alternative To Surety Bonds: Subcontractor Default Insurance

Subcontractor default presents a high level of risk for any construction firm. Despite an improvement in economic conditions in the last year, smaller margins due to a highly competitive market and weakened balance sheets from the economic recession create an environment with heightened subcontractor default risk. Historically, surety bonds have enabled construction managers (CM) or general contractors (GC) to transfer the risk of subcontractor failure, but they are not the only way to provide this benefit. An alternative solution is subcontractor default insurance (SDI), a first-party insurance policy that indemnifies a contractor for costs incurred as a result of a default in performance of one of its subcontractors. The costs in question may include those directly related to a defaulted subcontract as well as indirect costs.

SDI PROGRAM OVERVIEW

SDI may be written for CMs or GCs covering some or all of their projects enrolled in the policy during a policy period. Annual policy limits are available for up to $75 million for a single loss and up to $225 million for all losses that occur during a policy period. An indirect cost sublimit is available for up to $5 million per loss. GCs or CMs with annual revenues from $40 million to multibillions are eligible for this coverage.

The insured contractor (GC/CM) is responsible for prequalification of subcontractors and for undertaking all actions to resolve or settle any loss. Insured contractors benefit from a reduction in potential losses, thus keeping jobs on time and within budget. They will also experience more favorable pricing with their SDI programs as their subcontractor prequalification processes are improved.

CONSULTATIVE ADVICE

Managing subcontractor default is a critical part of a comprehensive risk management program. Any GC or CM implementing an SDI program should seek advice from his/her insurance broker and legal professional in the following areas:

• Market knowledge and analysis of program design options from the three carriers that serve this market (Zurich, Arch, and XL).

• Financial benchmark service that measures financial factors to identify those subcontractors that might present a high risk of failure.

• The GC/CM will also need assistance for the implementation and training concerning the benefits of SDI to clients' staff, project owners, public-private partnership (P3) consortiums, lenders, and enrolled subcontractors, as well as knowledge of subcontractor prequalification processes, including financial benchmarking and scoring.

• Claim preparation consulting services (including evaluation), document assembly, subcontract balance reconciliation, and negotiation to maximize recovery.

ADVANTAGES OF SDI

While there are a number of differences between subcontractor surety bonds and subcontractor default insurance, the following are the key advantages of SDI:

• Broader coverage than subcontractor bonding for indirect costs, including coverage for acceleration, delay, and extended overhead that are not normally included in traditional bond coverage, and with recovery potential up to policy limits for any default, regardless of subcontractor value.

• The insured contractor controls the claim process when a performance default occurs (finance to complete, hire replacement, subcontract or take job over).

• Project owners receive added protection with financial interest (additional insured) and dedicated limits endorsements, improving the credit profile of their project for the owners and lenders. XL's SDI product can also provide up to $25 million of coverage for the owner for the default of the CM/GC, a feature not available from any other carrier.

• A potentially more cost-effective option than subcontractor bonding (potential savings are more than 50% of surety costs if no losses occur).

JAMES L. BLY is the Construction Practice Leader in the Pittsburgh Office of Marsh USA, Inc.

OSHA Update – OSHA Cites Pennsylvania Contractor For Trenching Hazards

On May 15, 2013 OSHA cited Lumadue Excavating LLC for 12 safety violations involving trenching hazards. OSHA initiated two inspections under a special emphasis program on trenching and excavation when inspectors found unprotected trenches at two different work sites. One trench was 7 feet deep and the other was more than 5 feet deep. Proposed penalties totaled $178,860.

Two willful violations, with $92,400 assessed in penalties, involved the contractor's failing to provide a protective system to prevent a trench cave-in. A willful violation is one committed with intentional knowing or voluntary disregard for the law's requirements, or with plain indifference to worker safety and health.

Five repeat violations, with $73,920 in penalties, involved failing to instruct workers in the recognition and avoidance of hazardous conditions, provide a safe means of egress from trenches and ensure excavations are inspected daily by a competent person. A repeat violation is issued when an employer previously has been cited for the same or a similar violation of a standard, regulation, rule or order at any other facility in federal enforcement states within the last five years. OSHA cited this contractor with similar violations in 2008 and 2009.

Because of the nature of the hazards and the violations cited, OSHA placed Lumadue on its Severe Violator Enforcement Program, which mandates targeted follow-up inspections to ensure compliance with the law.

While excavating contractors face OSHA penalties and workers compensation claims for trenching accidents involving their employees, owners are generally not subject to civil liability for their contractor's failure to provide trench protection.

Under Pennsylvania law an owner of property does not have a duty to protect the employees of an independent contractor from risks arising from or created by the job contracted.

Celender v. Allegheny County Sanitary Authority, 208 Pa. Super. 390, 222 A.2d 461, 463 (1966). However, under Section 414 of the Restatement (Second) of Torts, the landowner that retains and exercises control over the work of the independent contractor can be held liable for failure to exercise that control reasonably; it states:

> One who entrusts work to an independent contractor, *but who retains the control of any part of the work, is subject to liability* for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care. Restatement (Second) of Torts § 414 (1965) (emphasis added) (Section 414). The Comment explains that the owner *has merely a general right to order the work stopped or resumed, to inspect its progress or to receive reports, to make suggestions or recommendations which need not necessarily be followed, or to prescribe alterations and deviations. Such a general right is usually reserved to employers, but it does not mean that the contractor is controlled as to his methods of work, or as to operative detail. There must be such a retention of a right of supervision that the contractor is not entirely free to do the work in his own way.*

Section 414 comment c (emphasis added).

In addition to the "control" exception, Pennsylvania courts recognize the "peculiar risk of harm exception". The Pennsylvania test for applying the peculiar risk exception requires that the risk must be one caused by something other than the contractor's negligence. *Dunkle v. Middleburg Municipal Authority*, 842 A.2d 477 (Pa. Cmwlth. 2004). In *Dunkle*, the parents of a worker who was killed by the collapse of a sewer trench brought a negligence action against the municipal authority that had hired the decedent's employer to excavate the trench. The decedent had been working in a deep trench excavated in shale; a trench box had not been installed and no other precautions had been taken. The plaintiffs argued that working in a trench excavated in unstable shale presented a special danger or peculiar risk. The Commonwealth Court disagreed, reasoning that working in a sewer trench in stable or unstable soil was nothing more than a common routine worksite procedure, requiring protective measures, such as a trench box, to support the walls. To accept the argument that all excavation work involved a special danger or peculiar risk would render the terms "special danger" or "peculiar risk" meaningless. *Dunkle*, 842 A.2d at 484. See also *Motter v. The Meadows L.P.*, 680 A.2d 887 (Pa. Super. 1996).

OSHA provides the following for sloping of excavations without benching, shoring or shielding:

Sloping. Maximum allowable slopes for excavations less than 20 ft (6.09 m) based on soil type and angle to the horizontal are as follows:

TABLE V:2-1. ALLOWABLE SLOPES

Soil type	Height/Depth Ratio	Slope angle
Stable Rock	Vertical	90°
Type A	¾:1	53°
Type B	1:1	45°
Type C	1½:1	34°
Type A (short-term)	½:1	63°

(For a maximum excavation depth of 12 ft)

FOR MORE INFORMATION, PLEASE CONTACT MARK T. CALOYER AT MTC@PIETRAGALLO.COM.

SEVEN STRATEGIES TO MANAGE CONSTRUCTION DEFECT RISKS

Claims for defective construction can be enormously expensive and time-consuming. As contractors struggle with the challenges of finding profitable work in a hypercompetitive environment, the most progressive construction organizations are researching risk and making conscious decisions about work acquisition, target project profiles and mitigation tactics that can help protect their balance sheets.

What techniques might help you avoid the lawsuits, expenses and potential damage to your reputation that accompany disputes around construction defects? There are seven strategies being used around the country to identify, manage and mitigate your exposures to these kinds of losses.

STEP ONE: *Refine your project appetite and match it to your insurance program.*

Since many construction insurers have sought to limit the amount of high-risk work that their insured contractors are performing, understand the profile of your most profitable jobs. When measuring profitability, remember to keep the books open on your project costs until the statutes of limitation and repose have expired. Warranty and repair costs need to be tracked and built into future estimates to help measure the true final job costs and ensure future profitability on similar projects.

Many contractors have set up separate companies to separate riskier work from the more "traditional" projects within their work program. Insurance carriers usually price their liability coverage based on the perceived or proven risk of your previous projects and upcoming backlog, and a "silo" strategy to isolate the more expensive, riskier projects can protect the liability rates for the projects with lower risk. This might make you more competitive on hard bid work and could help you acquire new work.

Some contractors also insure higher-risk projects through consolidated insurance programs, or "wrap-ups." This is another risk isolation technique that can protect the stand-alone pricing for more traditional commercial work. Insurance carriers typically view residential construction projects as riskier, but each carrier applies their own definition of what constitutes "residential." Multifamily "for sale" projects are viewed by most carriers as the riskiest, but any project that creates a homeowners association carries a higher potential threat of future litigation.

Pricing for project-specific or wrap-up programs is especially competitive in the current marketplace.

STEP TWO: *Determine what makes your liability insurer nervous.*

Take the time to familiarize yourself with the key exclusions and limitations within your general liability insurance program. Ask your broker to review all of the exclusions with you and explain what they mean, and ask to meet with your underwriter to clarify any gray areas. The more you know about how your insurer prices your risk, the more accurate your pricing estimates can become, and the more sustainable your insurance program will become over time.

STEP THREE: *Monitor your loss history and link it to your quality control/quality assurance efforts.*

Your insurers are constantly tracking the profitability of your account. They keep score by compiling a history of the losses that they have paid on your behalf, and they compare that with the premiums they have collected from you every year. If this loss ratio gets too high, either your prices will go up or your insurer will not offer you renewal terms.

Ask your broker for periodic loss reports, and review them with your project teams to identify any trends that might show preventable patterns.

Look backward for the last three to five years, and recognize that your insurance carrier will perform the same analysis when pricing your account. For example, if water-damage claims persist, focus on tougher standards and more frequent inspections on those building components or systems that may have failed on earlier projects.

Consider design peer reviews or constructability discussions during the preconstruction phases of complex projects.

STEP FOUR: *Negotiate your contracts.*

In the current bidding environment, owners know they have an advantage and are seeking to contractually transfer more risk downstream to contracting organizations. When possible, seek competent risk and legal advice and push back on risk allocations that are out of proportion to the work you perform or to the amount of profit or fee you might earn. We have seen several recent large construction defect claims paid where the contracting party built the project in conformance with the plans and specifications, but the contract terms obligated them to indemnify the owner for the negligent work of others that they did not control. Strong contractual guidelines can help mitigate this risk.

STEP FIVE: *Avoid new components and technologies.*

Unproven systems and products carry a higher risk of failure than time-tested, reliable components and have recently produced an uptick in claims frequency, particularly around "green" or renewable materials and designs. Be cautious about pioneering in these areas.

STEP SIX: *Make quality a larger component of your subcontractor prequalification process.*

Ask your subcontractors to augment their prequalification packages with their own liability loss history. Avoid those subcontractors with loss patterns that might affect your project or reputation.

STEP SEVEN: *Keep your ears open.*

Research those owners with a pattern of suing contractors, and only bid their work at margins that support the increased risk. Learn who the most effective attorneys and expert witnesses are, and consider hiring them to advise your team on how to avoid litigation before your next project starts. Ask your broker and insurer for suggestions to preserve your stellar track record and contain future insurance costs.

Construction defect disputes are complex, time-consuming, expensive and distracting. Consider a robust discussion of these seven steps at your next planning meeting, and select a few that your team feels can help you improve your construction performance and protect your net worth.

JODY T. WRIGHT is Senior V.P. and Construction Department Manager in the Denver Office of Lockton Cos. L.L.C.

Court Deems Contractors Exclusion to be Ambiguous and Imposes Coverage

The Seventh Circuit Court of Appeals recently grappled with a so-called contractors exclusion in a coverage dispute relating to injuries sustained by a worker at a construction site. Deeming the exclusion to be ambiguous, the court imposed coverage upon the insurer. *Atlantic Casualty Insurance Co. v. Paszko Masonry, Inc.*, 2013 U.S. App. LEXIS 11561 (7th Cir. June 7, 2013). The decision was written by a well-known jurist, Judge Richard Posner, whom many considered to be a worthy candidate for the United States Supreme Court. However, Judge Posner may be best known now for his snippy exchanges with current Supreme Court Justice Antonin Scalia.

The contractors exclusion was contained in a commercial general liability policy issued to Paszko Masonry, one of the construction firms working at the site, but the role of that particular firm is not clear from the decision. In any event, the exclusion was entitled "Injury to Employees, Contractors and Employees of Contractors." The exclusion purported to deny coverage for bodily injury to any "'contractor' arising out of or in the course of rendering or performing services of any kind or nature whatsoever by such 'contractor' for which any insured may become liable in any capacity." The exclusion did not define the term "contractor," but it did contain a provision which explained that the term "contractor" included but was not limited to "any independent contractor or subcontractor of any insured, any general contractor, or any independent contractor or subcontractor of any developer . . . or of any property owner, and any and all persons working for and providing services and or materials of any kind for these persons or entities mentioned herein." Further, the exclusion did not define the phrase "providing services . . . of any kind," nor did it contain any other explanation or example of what was meant by using that phrase.

Robert Rybaltowski was employed by Raincoat Solutions, a waterproofing company that submitted a bid for caulking of windows at an apartment building then under construction. The general contractor, Prince Contractors, was inclined to accept the bid, but it wanted assurances that Raincoat Solutions could perform satisfactorily. So, Raincoat Solutions agreed to perform a free demonstration, and it sent Rybaltowski to the site to caulk a few windows. After the demonstration, Rybaltowski was injured when a beam supporting masonry equipment fell upon him. Ironically, the subcontract awarding the job to Raincoat Solutions was signed about half an hour after the accident. Because there was no subcontract in place at the time of the accident, the general contractor could not insist upon contractual indemnification (hold harmless) language, nor could it request additional insured protection from Raincoat Solutions. In hindsight, perhaps the general contractor should have had some such protection in place before Rybaltowski was allowed on the site to perform the demonstration.

Rybaltowski sued the owner, the general contractor, and two masonry contractors. Those entities tendered defense of the suit to Atlantic Casualty. Citing the contractors exclusion, the insurer denied coverage to all of them and it initiated a declaratory judgment action to obtain a ruling that the policy afforded no coverage for Rybaltowski's accident. The district court ruled in its favor, holding that Raincoat Solutions was a contractor providing services by submitting the bid and performing the demonstration. Judge Posner and his colleagues disagreed, noting that the contractors exclusion was poorly drafted. In addition, Judge Posner questioned the attractiveness of a policy that contained such a rare and broad exclusion.

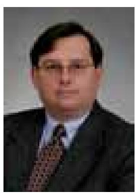
The appellate court found two ambiguities in the contractors exclusion and it resolved them both against the insurance company. Accordingly, it concluded that Rybaltowski was not a contractor (or, more appropriately a contractor's employee) when he got hurt.

The first problem area concerned the imprecise term "contractor." The court noted that the term was not defined in the policy. Instead, it was exemplified. The court added that "[t]he wording of the exclusion leaves uncertain whether Raincoat was a contractor simply because companies that engage in construction are called 'contractors,' or whether it did not become a 'contractor' until it signed a contract with Prince [the general contractor] until it provided materials or services other than the demonstration of caulking, or whether the demonstration itself was a service provided by a contractor." While it is obvious that the insurer favored the former interpretation, the court's decision does not reach any definite conclusion as to the version that it would adopt. It appears as though the court was leaning towards the notion that Raincoat Solutions was a contractor at the time it signed the subcontract, but not before that, which was when the accident occurred.

The second problem area concerned the phrase "providing services . . . of any kind." With regard to that phrase, the court lamented the fact that the policy provided no definition or explanation whatsoever. The court stated that the demonstration could be considered to be the provision of a service, either because the caulking remained on the windows or because the demonstration led to the execution of the subcontract and the provision of what were, unquestionably, construction services. The court also pondered whether the submission of the bid could also be viewed as a service because it too led to the demonstration and, eventually, to the signed subcontract. The court also noted that a plausible alternative interpretation was that services were not provided until the contractor (with or without a signed contract) began to do compensated work on the project. Again, while it is uncertain which interpretation the court adopted, it appears that it preferred the latter approach. Under that construction, Raincoat Solutions was not a contractor because the demonstration was done for free.

The court then observed, in the penultimate paragraph of the opinion, that the insurer could have closed these loopholes by excluding all construction workers from coverage, but it neglected to consider the definitional problems that such a proposal would have presented.

There are at least two lessons to be learned from *Atlantic Casualty.* First, from a risk management perspective, contractors need to consider the necessity of obtaining contractual protection before allowing prospective subcontractors and their workers onto the jobsite. Requiring contractual indemnity from the subcontractor would have been supported by consideration, in that the general contractor was considering making the award to the subcontractor if the demonstration were to be successful. Second, contractors and their subcontractors need to know whether their insurers or prospective insurers use contractors exclusions in an attempt to limit exposure from workplace accidents. If so, then the contractors and subcontractors may need to seek alternatives without any such exclusions. This concern would also apply to policies that are supposed to afford coverage for additional insureds.



For more information, please contact LOUIS C. LONG at LCL@pietragallo.com.

Pennsylvania Courts Allow *Quantum Meruit* Recovery Under HICPA

On July 1, 2009, Pennsylvania's Home Improvement Consumer Protection Act ("HICPA") came into effect. We previously reported on the anticipated changes we expected to see based on the many provisions of HICPA which mandated sweeping changes to home improvement contracts. One of the most controversial provisions of HICPA provided that no home improvement contract would be "valid or enforceable" against an owner unless it was in writing and contained the contractor registration number and was signed by both the owner or his agent and the contractor.

As anticipated, the Pennsylvania Courts have been called upon to address a contractor's right to recover for the work performed when no written contract is in effect and/or the contract is not valid. In two recent cases decided by the Superior Court, the ability of a contractor to recover under the doctrine of *quantum meruit* has been affirmed. *Quantum meruit* means the value of services performed.

In *Durst v. Milroy General Contracting, Inc*., 2012 Pa. Super. 179 (2012), the Dursts contacted Milroy to perform home improvements. The parties had an oral contract for payment of $2,694 for work to be performed. After the work was completed, Milroy submitted a written invoice to the Dursts but was not paid. Milroy filed a suit in District Court and a judgment was entered in Milroy's favor. The Dursts filed an appeal to the Court of Common Pleas and Milroy was directed to file a complaint. Milroy's complaint ultimately alleged an action for *quantum meruit.* The Dursts filed preliminary objections in the nature of a demurrer in which they asserted that "an attempt to collect on an oral home improvement contract is strictly prohibited by statute as of July 1, 2009," pursuant to HICPA.

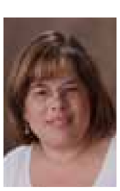
The trial court overruled the preliminary objection. The Court held that HICPA "does not speak to prevent recovery in such situations" where a contractor performed services without a contract and was left unpaid. The Dursts appealed the ruling to the Superior Court. On appeal, the Dursts argued that if HICPA permits a recovery under a *quantum meruit* theory in the absence of a written contract, HICPA would have no real impact on contractors in their dealings with home owners.

The Court explained that HICPA is silent as to actions in quasi-contract. In confirming that *quantum meruit* actions make sense under HICPA, the court explained that if these actions were forbidden, a home owner could prevail even if the work was perfect and they simply did not want to pay for it. The Court reasoned that this outcome would be an absurd result.

The Superior Court most recently decided the case of *Shafer Electric & Construction v. Mantia,* 2013 Pa. Super 111 (May 10, 2013). In this case, the Appellant, Shafer, was a contractor licensed only in New Cumberland, West Virginia. Shafer was not registered as a contractor under HICPA. The claim began when Shafer filed a mechanics lien against Mantia, followed by a complaint which sought *quantum meruit* relief. Mantia filed preliminary objections to the complaint which were granted by the trial court which concluded that the parties written contract was invalid and unenforceable under the HICPA and thus barred Shafer from seeking *quantum meruit* relief.

On appeal the Superior Court determined that Shafer could not be precluded from seeking *quantum meruit* recovery under HICPA. The Court commented on the seemingly inconsistent provisions of HICPA dealing with equitable relief. The Court determined that the provision of HICPA that permits a contractor to seek equitable relief which is then conditioned upon the contractor complying with HICPA is "puzzling". If HICPA had been complied with, the contractor would not be in a position of needing the equitable relief remedy. The Court concluded that the General Assembly's obvious purpose in drafting Section 517.7(g) of HICPA was to provide for an equitable remedy in a situation where there was no valid and enforceable written contract.

These cases provide some guidance on navigating the tricky and seemly inconsistent provisions of HICPA. For contractors, the cases provide reassurance that even if their contracts are not "letter perfect" they can still seek an equitable remedy in court.



For further information, contact MARY G. MARCH at MGM@pietragallo.com.

Many choices exist to communicate electronically or via "social media" both in and outside of the workplace. Ideas, opinions and experiences can be shared with coworkers and third parties not just via e-mail and text messages, but also on blogs, social networking sites, such as Facebook, LinkedIn or Twitter, wikis, virtual worlds and forums, podcasts, YouTube, newer bulletin board sites such as Pinterest and Instagram and photo-sharing sites. Some companies have established company-wide social networks or blogs to allow employees to easily communicate and constructively collaborate with one another internally, which can result in increased productivity. In the construction industry, companies may use social media for marketing purposes or to share successes or industry trends and may see social media taking a bigger role in many stages of the construction process, including solicitation, bidding, design, construction and project management and delivery. Because of seemingly constant advances in technology, information can be shared not only from a home or work computer, but also from individuals' own "smart" telephones, tablets or similar devices.

Because the use of social media has become readily available and commonplace for most people in the workforce, employers may feel the need to implement policies to govern the use of social media in the workplace. Although implementing such a policy may reduce the risk that employees will engage in behavior that could result in liability under both federal and state employment and other laws, an overbroad policy may also violate recent administrative rulings or legislation.

SOCIAL MEDIA AND THE NLRB

The National Labor Relations Board ("NLRB") has ordered that the National Labor Relations Act ("NLRA") requires that employers in unionized and non-unionized workplaces scale back on policies to the extent that they limit what employees may say online. Although this seems counterintuitive, since an employer may understandably want to seek to prohibit employees from making any comments via social media that refer to the employer in a disparaging, disrespectful or negative manner, the NLRB has advised that workers have the right to freely and openly discuss working conditions, which includes discussions via social media.

The NLRB's Office of General Counsel released three memos in 2011 and 2012, to offer guidance in this developing area. The first report, which was issued in August 2011, described cases in which the NLRB had conducted investigations relating to the use of social media in the workplace or by employees. In some of the cases involving employees' use of Facebook, the NLRB found the employees were engaged in "protected concerted activity," because they discussed terms and conditions of employment with fellow employees. In one case, it was found that a union engaged in unlawful coercive conduct by videotaping interviews with employees at a nonunion jobsite about their immigration status and posting an edited version on YouTube and Facebook. In some of the cases, provisions of the employers' social media policies were found to be overly-broad.

The second report, which was issued in January 2012, also examined several cases, seven of which involved questions about employer policies. Of those cases, five policies were found to be unlawfully broad, one was lawful, and one was found to be lawful following revision. The remaining cases involved the employers' discharge of employees because of comments posted on Facebook. Some discharges were held unlawful, because they flowed from unlawful policies. In one case, however, the discharge was found to be lawful despite an unlawful policy, because the employee's posting was not work-related. The report highlighted two main points:

• Employer policies should not be so sweeping that they prohibit the kinds of activity protected by federal labor law, such as the discussion of wages or working conditions among employees.

• An employee's comments on social media are generally not protected if they are mere gripes or rants that have not been made in relation to group activity among employees.

The third report, which was issued in May 2012, considered 7 employer social media policies. In 6 cases, the Office of the General Counsel found some provisions to be lawful and others to be unlawful. In the last case, the entire policy was found to be lawful.

The NLRB itself has also ruled that employer's policies of broadly prohibiting employees from making comments about the employer or other employees violates the National Labor Relations Act ("NLRA"). This appears to be counterintuitive, since an employer should have the right to protect itself from employees damaging its reputation, but the NLRB has placed greater importance on employees' right to communicate with one another and on the resultant goal of improving wages, benefits or working conditions. In cases involving too broad of a restriction, the NLRB has ordered that employees who were terminated for violating such a policy be reinstated to their positions and also that employers re-write their policies. The NLRB, however, also recognizes that mere one-sided rants about an employer by an employee will not be protected.

Recently, on May 8, 2013, the NLRB issued an advice memorandum in Skinsmart Dermatology, which clarified its position regarding employees' use of social media to gripe about their employer pursuant to their Section 7 rights under the NLRA. In that matter, ten current and former employees participated in a private Facebook group message, which involved a string of vulgar rants by one employee about another employee who was returning to work for the employer, including that the employer was "full of s***" and the employer should "F***ING FIRE ME …Make my day…." The employee was terminated. The NLRB found that the messages were not a protected concerted activity under the NLRA and upheld the termination, since the messages did not contain any shared employee concerns over terms and conditions of employment.

On May 2, 2013, in New York Party Shuttle, the NLRB decided, however, that a tour bus driver should not have been terminated for complaining on Facebook and in e-mails about not having health insurance or vacation benefits and about paychecks that he claimed bounced and suggesting his fellow employees should unionize. The NLRB found the comments were protected activity under the NLRA and ordered that the employee be reinstated, with back pay.

Similarly, on April 19, 2013, the NLRB, in Design Technology Group, decided that an employee's Facebook posts criticizing how a manager handled employees' concerns regarding the closing time of the store because of safety issues related to the location of the store were a "classic connected protected activity." The employees who posed critical messages on Facebook were terminated by the manager in question and the NLRB found that their terminations constituted unfair labor practices.

The NLRB also issued several decisions in 2012 in which it found employees' communications via social media were protected activity. In December 2012, in Hispanic United of Buffalo, the NLRB held an employer's termination of five employees was unlawful despite their posting comments on Facebook that were critical of a co-worker who intended to complain to management about their work performance. The employees were terminated for "bullying and harassing" the co-worker in violation of the employer's policies. The Board majority, however, applied settled Board law to social media and found that the Facebook exchange was concerted activity and, thus, protected by the NLRA. Similarly, in September 2012, in Costco Wholesale Corp., the NLRB ruled that an employer's overbroad social media policy violated the NLRA because it prohibited employees from posting statements "that damage the Company, defame any individual or damage any person's reputation or violate the policies outlined in the Costco Employee Agreement." The NLRB ordered Costco to rescind the policy.

It should be noted that these decisions may be overturned in light of recent rulings by several federal courts finding that recess appointments made to the NLRB by President Obama were unconstitutional. The NLRB is seeking to appeal one of these rulings in *NLRB v. Noel Canning*, Case No. 12-1281, to the U.S. Supreme Court. If the Supreme Court declines to hear the appeal or affirms the decision finding that the NLRB lacked a quorum for its decisions, all of the decisions by the NLRB since January 2012, will be invalidated, including the above decisions regarding social media. The matter was distributed for Conference of June 20, 2013. Until a decision is reached by the Supreme Court, however, employers should act out of an abundance of caution and continue to adhere to the NLRB's rulings.

FEDERAL AND STATE LAW AND SOCIAL MEDIA

Employers should also be cognizant of other federal and state laws that may be violated in connection with the use of social media. Federal and state laws prohibit employment discrimination based on a number of protected factors, including race, color, religion, sex, national origin, pregnancy, age, disability and genetic information. Some state and local laws also prohibit employment discrimination based upon sexual orientation or gender identity, marital status and political affiliation. If an employer views an employee's social media and discovers information relating to these protected characteristics, it should not consider that information in making any employment decisions.

With respect to applicants, social media can provide employers with benefits in recruitment and selection, since having more information that is easily accessible can decrease the time and energy needed to research potential candidates and also result in finding relevant and quality candidates. As with employees, however, employers need to be aware that the use of social media also carries a risk of employment discrimination claims being filed. As a result, employers should be cautious to not use information regarding any protected characteristics obtained via social media when making hiring decisions.

Requesting access to applicant's social media may have privacy implications and even violate statutes in some states. State legislatures have begun to restrict employers' attempts to require applicants or employees to disclose social media passwords. Arkansas, California, Colorado, Maryland, Michigan, New Mexico, Oregon, Utah and Washington, all have laws that are either currently effective or soon to be effective. The majority of the remaining states have introduced similar bills, including Ohio, Pennsylvania, New Jersey and West Virginia. New Jersey's law even goes as far to prevent employers from inquiring if employees or applicants have a social media account at all. Federal legislation, the Password Protection Act of 2013 (H.R. 2077), was introduced in May 2013, and is currently in committee.

SOCIAL MEDIA POLICIES

In light of the above rulings and guidance, to the extent that an employer would like to implement a social media policy, it should not adopt a broad, catch-all policy, but one that is tailored to specific conduct, such as hateful or truly defamatory speech. In addition, instead of broadly banning the posting of "confidential information," employers should consider referring to what specific information should not be posted, such as trade secrets or the employer's methodologies, business strategies or company marks or logo. Overall, employers should provide examples of the types of information that the policy protects and should ensure that the examples do not involve or limit protected activity in any way. In addition, employers should continue to include and enforce provisions relating to sexual harassment, abusive activity or workplace violence and make such policies and provisions applicable to the use of social media.

Because courts and applicable rules allow for and indeed require the discovery of electronically stored information by parties to a lawsuit, employers should include social media content in any document retention policies, so that the information is available in the event of future litigation. Similarly, employees should be instructed to not delete or remove any postings once a threat of future litigation becomes possible. Although it may be argued that relevant information shared on social media sites is hearsay, courts have admitted information where it is deemed to be an admission of a party or to impeach witnesses' credibility.

Employees should be instructed to carefully consider any intended communications via social media and that once they post information, it is open to viewing by the public and cannot be taken back. Importantly, employees should be trained, so that they understand any guidelines that are implemented and how they apply to them to their conduct. Managers should also be trained regarding the policy and their duty to investigate complaints relating to conduct that occurs in the context of social media. Finally, as with all policies in the workplace, any social media policy must be enforced evenhandedly.

For more information, please contact JENNIFER R. RUSSELL at JRR@pietragallo.com.

Employees Accused by Former Employer of Breach of Duty of Loyalty, Breach of Fiduciary Duty, and Conversion

Pietragallo Gordon Alfano Bosick & Raspanti scored an appellate victory for the Defendants in the Superior Court of Pennsylvania on behalf of Cole Haley and Anthony Piroli, the principals of Evolution Sports Institute. Haley and Piroli started a performance enhancement fitness training business. Their clientele consisted of a mixture of NFL football players and youth athletes. Many of the original clients of the new business were former customers of Plaintiff Power Train Sports Institute (PTSI).

Haley worked as Director of Operations and Piroli as a personal trainer for prior employer, PTSI. PTSI sued their former employees under a number of legal theories, *inter* alia, breach of duty of loyalty, breach of fiduciary duty, misappropriation of trade secrets, and conversion. A summary judgment in favor of the Defendants was granted by the trial court and Plaintiff appealed.

PTSI first challenged the dismissal of its breach of duty of loyalty claim claiming that Haley and Piroli improperly solicited PTSI's customers while still employed by PTSI. The Superior Court noted that Haley and Piroli were not subject to a non-compete agreement, that the clients that left with them were not under contract with PTSI, and that PTSI failed to produce evidence that Haley and Piroli improperly solicited PTSI customers.

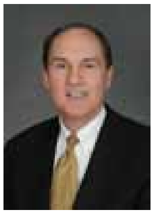
Next, PTSI challenged the dismissal of its breach of fiduciary duty claim against Haley. PTSI argued that because Haley was the most senior manager at PTSI's Wexford facility who had oversight of that location's day-to-day operations, Haley owed a fiduciary duty to PTSI. The Superior Court said that Haley's status as manager does not necessarily subject him to a fiduciary duty as contrasted with officers and directors who stand in a fiduciary relation with a corporation. The Court described what a "fiduciary duty" is which in essence is trust and reliance on one side, and a corresponding opportunity to abuse that trust for personal gain on the other. The Court went on to say that even if Haley contacted PTSI's clients while still employed by PTSI, PTSI presented no evidence that Haley and PTSI dealt on unequal terms, that is, that there was an overmastering influence on the one side, or, on the other side, weakness, dependence or trust, justifiably reposed. Haley's right to compete included the right to divert customers from PTSI.

The Court reiterated the long standing rule in Pennsylvania that the solicitation of customers and use of customers lists by a former employee who seeks to compete with his former employer is permissible unless there is a breach of an express contract or violation of some confidence.

PTSI's third issue challenged the dismissal of its conversion claim. Haley and Piroli removed a copy of the client training files from PTSI's possession without PTSI's consent. Upon demand by PTSI the files were returned. The Court quoted the Restatement (2nd) of Torts §222A that conversion is properly limited to those serious, major, and important interferences with the right to control the personal property which justify requiring the defendant to pay its full value. It was pointed out in the Court's opinion that the principal of PTSI admitted during discovery that the information concerning training results is not proprietary and also admitted that the workout sheets were given out to clients and that the clients were free to give the sheets to anyone they chose.

The Court also dealt with PTSI's challenge to the dismissal of its claim for sanctions based on Haley's and Piroli's alleged spoliation of electronically stored evidence from their IPhones. The Superior Court found that the trial court, did not abuse its discretion when it found that the deletions were routine and not motivated by bad faith.

This case is a reminder that businesses should consider entering into non-compete, non-disclosure or non-solicitation agreements with their key employees who are trusted with



confidential business information.

PTSI, INC. v. Cole Haley, Anthony Piroli, and Evolution Sports Institute LLC, No. 684 WDA, Superior Court of Pennsylvania (May 24, 2013)

JOSEPH J. BOSICK serves as Chair of the Construction Practice Consortium. Joe was the attorney for the successful Defendants at both the trial court and the appellate level. For more information, you are welcome to contact Joe Bosick at (412) 263-1828 or e-mail him at JJB@Pietragallo.com.

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