CONSTRUCTION LEGAL EDGE

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Articles contained in this issue of the CLE:

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MECHANICS LIENS IN PENNSYLVANIA

A mechanics' lien is the statutory means of securing payment for labor and materials furnished in the improvement of real property. Mechanics' liens are designed to protect contractors from recalcitrant landowners and, likewise, subcontractors from recalcitrant contractors. Pennsylvania's Mechanics' Lien Law can be found at 49 P.S. §§1101-1902. Mechanics' liens may be filed by contractors, first tier subcontractors, and second tier subcontractors. 49 P.S. §1301. Lien waivers are prohibited with the exception of residential construction projects under $1 million and for subcontractors who are guaranteed payment by contractors in the form of posted bonds. 49 P.S. §1401.

To obtain a mechanics' lien in Pennsylvania, two procedural steps must be fulfilled. First, a mechanics' lien must be filed and perfected pursuant to statute. 49 P.S. §1501-10. Second, the lienholder must institute an action to enforce the lien pursuant to the Pennsylvania Rules of Civil Procedure. 49 P.S. §1701(a).

To perfect a lien, claimants must serve the owner with written notice **within one month** after filing the claim. 49 P.S. §1502(a)(2). Subcontractors, at any tier, have an additional notice requirement. In every case, the subcontractor must serve upon the owner written notice of the subcontractor's intention to file a lien **at least 30 days** before filing the lien. 49 P.S. §1501(b.1). The formal notice must include:

(1) The name of the party claimant;
(2) The name of the person with whom he contracted;

(3) The amount claimed to be due;
(4) The general nature and character of the labor or materials furnished;
(5) The date of completion of the work for which claim is made;
(6) A brief description sufficient to identify the property claimed to be subject to the lien. 49 P.S. §1501(c).

If this specific information is not included in the formal written notice, the lien claim itself may be stricken and lost forever. Notice can be served by first class, registered, or certified mail, or by the sheriff, or if service cannot be so made then by posting upon a conspicuous public part of the improvement. 49 P.S. §1501(d).

The claim must be filed with the prothonotary **within six months** of the day the claimant completes its work. If the improvement is located in more than one county, the claim may be filed in multiple counties, but the claim is only effective for the part of the improvement in the county it was filed. 49 P.S. §1502. The filing must include similar information provided in the formal notice:

(1) The name of the party claimant and whether he files as contractor or subcontractor;
(2) The name and address of the owner or reputed owner;
(3) The date of completion of the claimant's work;
(4) If filed by a subcontractor, the name of the person with whom the subcontractor contracted, and the dates on which preliminary notice, if required, and of formal notice of intention to file a claim was given;
(5) If filed by a contractor under a contract or contracts for an agreed sum, an identification of the contract and a general statement of the kind and character of the labor or materials furnished;
(6) In all other cases than that set forth in clause (5) of this section, a detailed statement of the kind and character of the labor or materials furnished, or both, and the prices charged for each thereof;
(7) The amount or sum claimed to be due; and
(8) Such description of the improvement and of the property claimed to be subject to the lien as may be reasonably necessary to identify them.

Service of the notice of filing of claim shall be made by the sheriff, or if service cannot be so made, then by posting upon a conspicuous public part of the improvement. Id.

An Affidavit of Service of Notice, or the Acceptance of Service, must also be filed **within 20 days** after service. This affidavit must contain the date and manner of service. Failing to file an affidavit of service may cause the lien claim to be stricken. Id.

The second step in obtaining a mechanics' lien – the enforcement of the lien – is governed by the Pennsylvania Rules of Civil Procedure. 49 P.S. §1701(a). An enforcement action, which is initiated by the filing of a Complaint, Pa.R.C.P. §1653, must be commenced within two years of the filing of the claim. 49 P.S. §1701(b).

Service requirements under the Pennsylvania's Mechanics' Lien law are strictly construed. If all of the service requirements are not met, a Complaint will be stricken. *See* Regency Investments, Inc. v. Inlander Ltd., 855 A.2d 75, 77 (Pa. Super. 2004); Tesauro v. Baird, 335 A.2d 792, 796 (Pa. Super. 1975).

As the courts regularly strictly construe the statues governing mechanics' liens, in lieu of applying the more forgiving Rules of Civil Procedure, parties intending to file a mechanics' lien must be aware that missing a single deadline may constitute a waiver of the protections afforded to them by statute.

If the mechanics' lien is granted, purchase money mortgages and open-end mortgages, which are used to pay all or a portion of the cost of completing erection, construction, alteration, or repair of the mortgaged property, take priority over mechanics' liens. 49 P.S. §1508.

Joseph J. Bosick serves as Chair of the Construction Practice Consortium. For questions, you are welcome to contact Joe Bosick at (412) 263-1828 or e-mail him at JJB@PIETRAGALLO.com.

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OUT WITH THE OLD – IN WITH THE NEW – A201 GENERAL CONDITIONS

As of June 1, 2009, the American Institute of Architects (AIA) will no longer make available for sale or use the 1997 versions of its standardized contracts forms, including the 1997 version of the widely used A201 General Conditions. In fact, the AIA will block access to and the use of the 1997 documents on its database so that no new contracts can be created using these old forms.

Importantly, the updated A201 General Conditions contain significant changes from the 1997 version. Since the A201 General Conditions apply to nearly every major AIA contract form and delivery method, these recent modifications will have a critical impact on all future projects and their participants. It is very important that in the coming months, owners, contractors, and architects familiarize themselves with these recently enacted changes.

One of the most significant changes in the updated General Conditions is an overhaul of the various claims handling procedures. For instance, in the prior version of the AIA documents, the architect was charged with approving or denying claims and disputes between the owner and the contractor. In the updated documents, the architect no longer occupies this important rule. Instead, the parties may designate a person or entity to serve as the initial decision-maker for disputes between the owner and the contractor. Similarly, the parties may now choose (in a check-the-box format) from several methods of binding dispute resolution, which include arbitration, litigation, or any other form of dispute resolution selected by the parties.

Another important change deals with the accrual of causes of action arising from the project. Notably, this provision in the 1997 version of the General Conditions was often modified by owners and their counsel so that the language would conform to both the common law and the applicable statute of limitations in the jurisdiction of the project. It would appear that this regular change required by owners and their counsel has finally had an impact on the drafters of the A201 General Conditions. Specifically, the recently enacted version of the A201 provides that the owner and the contractor shall commence all claims against the other relating to the contract "within the time period specified by applicable law, but in any case not more than 10 years after the date of substantial completion". This modification essentially encompasses the modifications that were generally requested by owners and their counsel which enabled the owner to take full advantage of the "discovery rule" that already exists in most jurisdictions for purposes of determining the accrual of claims.

The updated General Conditions also include modifications relating to a contractor's right to obtain financial disclosures from the owner, the contractor's duty regarding concealed or unknown conditions, and modifications to the required insurance coverages.

It is imperative that all individuals engaged in the construction industry familiarize themselves with the modifications to the A201 General Conditions, and gain an understanding of how these modifications will impact the performance and delivery of construction services.

If you have questions or would like to learn more about the changes to the A201 General Conditions, you are welcome to call **Dave Franklin** at (412) 263-1825 or e-mail him at DPF@PIETRAGALLO.com.

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PENNSYLVANIA GENERAL CONTRACTORS BEWARE – YOU MAY BE UNINSURED FOR DAMAGES CAUSED BY YOUR SUBCONTRACTORS' FAULTY WORK.

A general contractor may expect that a commercial general liability (CGL) insurance policy, providing coverage for a broad range of liabilities, will include damage caused by defective construction performed by subcontractors. In fact, the standard CGL insurance policy was revised by the Insurance Services Office in 1986 to provide general contractors "coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder [i.e., the general contractor] itself." United States Fire Insurance Co. v. J.S.U.B., Inc., 979 So.2d 871 (Fla. 2007). The change was accomplished, for the most part, by modifications to various exclusions affecting the so-called business risks. Unfortunately, despite those changes, general contractors doing business in Pennsylvania can not assume that their current CGL policies will automatically cover damage caused by the faulty work of their subcontractors.

To the surprise of many, Pennsylvania appellate courts have drastically limited the scope of coverage available to general contractors under their CGL policies for damages arising from deficient work irrespective of whether the work was performed by the general contractor or by a subcontractor. These decisions began in 2006, when the Pennsylvania Supreme Court decided Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial

Union Insurance Co., 589 Pa. 317, 908 A.2d 888 (2006), and culminated late last year with the Pennsylvania Supreme Court's refusal to review the Superior Court's decision in Millers Capital Ins. Co. v. Gambone Bros. Development Co., 941 A.2d 706 (Pa. Super. 2007). The result of this line of cases is that Pennsylvania appellate courts seem intent on applying a bright line rule that damage caused by flawed work does not constitute an "accident" and, therefore, does not give rise to an "occurrence" under commercial general liability policies. *See*, *e.g.*, Kvaerner, 589 Pa. at 335-36, 908 A.2d at 899. As such, Pennsylvania courts often do not examine the changes to the business risk exclusions, deeming them to be irrelevant to the application of the policy. *See*, *e.g.*, Millers Capital, 941 A.2d at 718.

Unfortunately, if general contractors fail to address the impact of this bright line rule, the financial loss associated with major damage caused to a project because of faulty subcontractor work may ultimately be the responsibility of the contractor. Before the Pennsylvania appellate courts established the no-coverage-for-faulty-work rule, most general contractors relied on the fact that they would be protected by construction contracts that actually included insurance provisions that were drafted at a time when subcontractor faulty work coverage would have been included in CGL policies. These contracts are still being used by the contracting community and should be carefully reviewed to insure that the court's elimination of CGL coverage for damage caused by faulty subcontractor work is addressed by project parties to remedy the significant exposure that has been created by this development. Additionally, general contractors should work with their insurers to provide an endorsement giving back the coverage that was apparently eliminated by cases such as Kvaerner and Millers Capital.

The Construction Practice Consortium is available to provide counsel to avoid the potential financial impact of the no-coverage-for-faulty-work rule embraced by Kvaerner and Millers Capital.

If you have questions regarding this article, you are welcome to call **Tim Hazel** at (412) 263-4327 or e-mail him at TMH@PIETRAGALLO.com.

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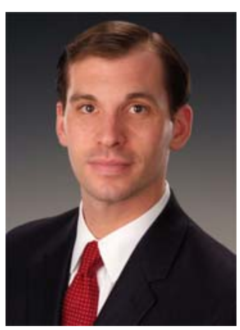

A NEW ERA IN GOVERNMENT CONTRACTING

Given the current economic downturn and the transfer of power which occurred in Washington on January 20, 2009, it is crucial for contractors and taxpayers alike to analyze certain regulations that became effective in the waning days of the Bush administration and review how they may be applied by the Obama Administration. The Contractor Code of Business Ethics and Conduct, a comprehensive and onerous regulation of the Department of Defense ("DOD"), the General Services Administration ("GSA"), and the National Aeronautics and Space Administration ("NASA"), became law on December 12, 2008, and is codified at 48 C.F.R. §52.203-13 (2008). This amendment to the Federal Acquisition Regulation ("FAR") requires government contractors to create corporate infrastructure to detect unethical behavior and, more importantly, the mandatory disclosure of any such behavior detected by the company to the federal government. This presents a significant sea change for the contracting industry.

The New Ground Rules

Under this new code, government contractors who are awarded projects with a value in excess of $5,000,000, and an anticipated duration in excess of 120 days, shall institute a written code of business ethics and conduct. This written code must be in place within 30 days of the award of the contract. Within 90 days of award of the contract, the contractor must institute an ongoing business ethics awareness and compliance program, including training for principals and employees of the business and a full internal control system. Perhaps the most daunting requirement placed on government contractors under this new provision, and the most drastic departure from past practices, is the following mandatory disclosure requirement:

> The Contractor shall timely disclose, in writing, to the agency Office of the Inspector General … whenever, in connection with the award, performance, or closeout of [the] contract or any subcontract thereunder, the Contractor has credible evidence that a principal, employee, agent, or subcontractor of the Contractor has committed … a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity … or … a violation of the civil False Claims Act.

Of significance, this disclosure requirement extends until three years have elapsed following the date of the final payment on the contract, but it is not retroactive.

The nature and timing of these disclosures are topics of great interest and were discussed at length in the November 12, 2008 publication of the new Code in the *Federal Register*. Contractors need not disclose past conduct of an employee discovered during a background check, for example, that an applicant was convicted of bribery, but commentary to the new Code suggests that such information should be part of the decision whether to hire the employee. Past criminal behavior of any type bears on that person's integrity and his ability to be an effective role model for company staff. The more difficult decisions arise when corporate compliance programs detect evidence of ongoing fraud.

Higher Stakes

Contractors who rely on federal money for a substantial portion of their income must review these requirements carefully. A violation of the Contractor Code of Business Ethics and Conduct provides for suspension or debarment of a contractor. It may even form the basis for whistle-blower lawsuits by insiders who become aware that these provisions are not being followed.

The federal government, along with twenty-two (22) states and the municipalities of Chicago, New York, and the District of Columbia, have False Claims Acts in place that allow for private citizens to blow the whistle on companies submitting false or fraudulent claims for payment to the government. Individuals with knowledge of such unlawful practices have financial incentive to come forward and file these "*qui tam*" suits. The statute provides for the whistle-blower to receive up to 30% of any recovery received by the government. The contractor may be exposed to treble damages and sizeable penalties, including the payment of the whistle-blower's attorneys' fees and costs. Although recent recoveries under the statute have occurred in the pharmaceutical industry, and specifically in off-label marketing cases, defense contracting has been the subject of many past *qui tam* actions. Under the new Code, if a contractor certifies to the government that it has instituted a written code of business ethics and conduct and is in full compliance, but an employee or insider discovers that is not so, the potential exists for any claims for payment made by that contractor to be tainted as false and susceptible to penalties under the False Claims Act.

Evolution of the Code

Of course, this new Code is not without its vocal critics. This rule was promulgated in response to a request made to the Office of Federal Procurement Policy by the Department of Justice and in response to the Close the Contractor Fraud Loophole Act. In the publication of the final rule in the *Federal Register*, 28 pages of comments and responses followed the background and summary of the regulation. Respondents to the proposed version of the new Code expressed concern over the time and money required of contractors to comply with the new regulation. The Department of Defense, the GSA, and NASA made clear that there will be additional costs and effort required on the part of contractors that do not have these important measures already in place, but these steps are reasonable and justified to mitigate "other and larger risks to the success and efficiency of Government Projects". Part of the justification provided for such measures is that some contractors have already invested in such precautions, and this rule will "level the playing field in competitive environments."

In the highly competitive environment of government contracting, mandatory disclosure is a monumental step forward from the past policy of voluntary disclosure (a policy largely ignored by contractors for the past 10 years). Mandatory disclosure has been adopted by the banking industry and public companies, and the practice has been stressed by the U.S. Sentencing Commission and the Department of Justice. Defense contracting is a massive industry for the United States, but its reputation has not always been the most pristine. Anne Flaherty of the Associated Press published an article on March 23, 2009 entitled <u>Def. Sec. Gates: Use of Private Contractors 'Vital' in Afghanistan, US Military's 'Help Wanted' Sign</u>, which addressed this very point. The mere mention of Blackwater, for example, is enough to evoke a negative impression of the industry based upon its errors in Iraq as a defense contractor – which is undoubtedly the reason the company recently changed its name to Xe.

With the U.S. currently entrenched in military activity in Iraq and Afghanistan, as well as in many other parts of the globe, many government contractors are providing large-scale support to U.S. troops. This new Code will impact how our country operates around the globe. As of March 23, 2009, there were 71,700 U.S. government contractors in Afghanistan alone; this was more than double the number of U.S. troops in that country at the time. In the wake of Blackwater's much publicized failures in Iraq, for example a drunken Blackwater employee fatally shooting an Iraqi politician's bodyguard, the new Code appears relevant and needed. Despite these well-known issues, the first proposed version of the new Code included an exception for overseas contacts. One agency OIG opined:

> [I]t is counterproductive to exclude contracts performed entirely outside the United States because the United States is still party to such contracts and may be victimized when overpayments are made or fraud occurs in connection with those contracts … the contracts require greater vigilance because they are performed overseas where U.S. resources and remedies are more limited … and the inclusion would reduce the vulnerabilities that often plague overseas programs and increase the effectiveness of those programs.

The agencies agreed, and no such exclusion for contracts performed outside of the U.S. made its way into the final version of the Code.

The New Administration

President Obama issued a Memorandum for the Heads of Executive Departments and Agencies on March 4, 2009, without explicitly referencing safety and security concerns, but with a clear message of fiscal responsibility. Spending on government contracts has more than doubled since 2001, exceeding $500 million in 2008. The President cites a recent GAO study conducted in 2008 of 95 "major defense acquisition projects" that found cost overruns of 26%, totaling $295 billion over the life of the projects. In an effort to curb wasteful spending, President Obama has directed the following:

> the Director of the Office of Management and Budget (OMB) … to develop and issue by July 1, 2009, Government-wide guidance to assist agencies in reviewing and creating processes for ongoing review of existing contracts in order to identify contracts that are wasteful, inefficient, or not otherwise likely to meet the agency's needs, and to formulate appropriate corrective action in a timely manner. Such corrective action may include modifying or canceling such contracts in a manner and to the extent consistent with applicable laws, regulations, and policy.

The President has instituted a tight timeline for this project and has set a deadline of September 30, 2009 for the Director of OMB to issue "Government-wide guidance" to govern the use of no-bid contracts versus competitive contracts, the assessment of when such contracts are needed or appropriate, and the oversight of these contracts going forward.

With heavy reliance on contractors, especially in the battle zones of Iraq and Afghanistan, the juxtaposition of the new Contractor Code and President Obama's March 4th Memorandum sets up a significant sea change in defense and procurement contracting. The new Administration is pushing for a leaner workforce and has not indicated any intent to repeal the new Code. Therefore, the contractors remaining after the intended thinning of the work force must spend time and money to create stringent ethical rules and notify the government of any credible evidence of unethical behavior by its own employees.

Will government contracting thrive, or will contractors find the negatives outweigh the positives of receiving paychecks from Uncle Sam? Aaron Smith's February 10, 2009 article published on CNNMoney.com entitled Military Recruitment Surges as Jobs Disappear provides interesting data. Given the historic level of job losses in the U.S., military recruiting is meeting and, in some cases, exceeding its goals, even though more than 4,800 soldiers have been killed in Iraq and Afghanistan. The U.S. military provides a stable source of income and benefits when the U.S. civilian market lost 2.6 million jobs last year alone. Our country has so heavily relied upon defense contractors abroad, that it appears unlikely recruiting efforts will surmount the nearly 72,000 men and women needed in Afghanistan alone to replace the current workforce.

The Future

Although excessively stringent implementation and high costs could lead to companies dropping out of the race for some contracts, procurement, and defense contracting is too lucrative a business for contractors to crumble under the added cost of implementing ethical guidelines. As, and if, the new Code is enforced and the Obama Administration sets it course, contractors should proceed cautiously in a new and changing regulatory environment. Contractors may be wary of the federal government imposing more and more regulations on an industry with fewer and fewer officials to monitor compliance, but these changes are here to stay and counsel must be ready to assist clients in navigating the new terrain.

For more information, contact **Marc S. Raspanti** or **Douglas K. Rosenblum** at (215) 320-6200 or e-mail at MSR@PIETRAGALLO.com or DKR@PIETRAGLLO.com.

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