

The Amended PA Mechanics Lien Law –

How will this change your Risk Management?

by **Michael J. Mitchell** and **Jason A. Copley**

Contractors, subcontractors and suppliers working on private construction projects in Pennsylvania have been accustomed to waiving their lien rights. That is because the law in the Commonwealth supported the enforcement of waivers signed by contractors.

This changed on January 1, 2007, when amendments to the lien law became effective and voided waivers signed by contractors on private construction projects. Waivers are still enforceable, however, only where a general contractor posts a payment bond and for residential projects that have a value of less than \$1,000,000. There are other changes to the law, but your Risk Management practices will be most impacted by the fact that sub-subcontractors and suppliers to subcontractors can now file liens. The changes also provide for an increase in the time to file liens from four months to six months.

What does all of this mean to you and your Risk Management policies? First of all, the only certain thing is that the changes in the law bring uncertainty. Owners, lenders, general contractors, subcontractors and suppliers all have different interests and views about the changes. You may already have heard that some companies are very concerned about



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the law and will make significant changes to their business practices, while others will take a more measured approach.

It is clear that most general contractors do not like the changes because now they have the added

task of policing payments to multiple tiers of subcontractors and suppliers. Otherwise, they are exposed to having to pay twice (i.e., “Double Jeopardy”) in order to avoid having an angry owner who has a lien filed against their project even though they have made all of their required payments.

Many subcontractors, sub-subcontractors and suppliers to subcontractors like the law because they have another mechanism and added leverage to insure that they will be paid. They can threaten to file a lien or make a bond claim. On the other hand, many subcontractors will not like this change to the law (which voids lien waivers) if their payments are held up as general contractors endeavor to make sure subcontractors have paid, or will pay, everyone they owe for the job. This hold up will get extended every time a sub-subcontractor contacts a general contractor and complains that payment is owed no matter what the circumstances.

What else may general contractors do to avoid “Double Jeopardy”? We expect to see more “Joint Checking” (i.e., checks made payable to subcontractors and suppliers). Obviously, subcontractors will be unhappy about joint checks for many reasons, not the

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least of which is being forced to disclose amounts owed to suppliers for equipment or for a quantity of material delivered to a job.

We expect to see an increase in the bonding of private jobs as owners and lenders seek to avoid the risk of liens on their projects. From an owners' perspective, this risk management technique is advisable because the cost is minor (approximately 1% of the total cost of construction) and it eliminates the threat of having their building encumbered by a Mechanics' Lien. If an owner wants to avoid this added cost, they may find that their bank or other project funding source will demand this protection.

In turn, more general contractors and their sureties will now require payment bonds from their subcontractors. This adds more cost to the job (i.e., 1% to 2%), but this added expense may be less than a general contractor's administrative costs for issuing joint checks and constantly policing payments made by subcontractors to their subcontractors and suppliers. A subcontractor's payment bond will basically guarantee that a general contractor will not experience Double Jeopardy.

Subguard®, which is an insurance product written by Zurich Insurance Company, is often

characterized as a replacement vehicle for Subcontractor Payment and Performance Bonds. A General Contractor who purchases a Subguard® Policy is covered, subject to a Large Deductible, for "Double Jeopardy." However, a Subguard® Policy is usually not written to cover the Project Owner. From an owner's perspective, Subguard® is not a replacement to bonding the General Contractor. Under the new law, if a private owner or lender wants Waivers of Liens signed by contractors to be enforceable, the General Contractor needs to bond the job. A Subguard® Policy will not provide for an enforceable Waiver of Lien Rights.

Everyone agrees that the changes to the lien law will result in more uncertainty until the law is clarified by judges making decisions on specific cases. In the meantime, everyone involved with construction will have to make sound decisions to limit the risks they will face with the changes in the law. This is true whether the risk is getting paid slowly or being forced to pay twice for work.

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Some Other Quick Facts:

1. PAYMENT BONDS Generally, when someone asks for a "bond," they get a "Performance" Bond and a "Payment" Bond. The standard premium charged by the Surety Company includes the cost for both bonds. Unfortunately, if you only ask for a "Payment" Bond, the premium may not be discounted.

2. WAIVERS Giving up lien rights ahead of time or a partial waiver for payments received up to a certain date. Waivers are usually part of the construction contract terms, which are agreed upon and executed before the project begins.

3. RELEASES Giving up lien rights after work is done. Releases are usually given in return for payment during the construction phase when monthly requisitions are submitted.

4. LIEN RIGHTS A subcontractor's and supplier's lien rights expire six (6) months after the last day that labor or material was delivered to the job. Both subcontractors and suppliers must give notice to the owner 30 days before a lien is filed. Generally speaking, punch list or warranty work will not extend your lien rights.

5. BOND CLAIMS If a payment bond is posted and there is an enforceable lien waiver on the project, subcontractors and suppliers will have to get a copy of the General Contractor's bond so they can give timely notice of a claim under the bond and then file suit in the time provided. The changes to the law do not state the terms required for the bond so claimants must be careful not to give up their lien rights. It is likely that there will be litigation over this issue if a bond has requirements that are more restrictive than the lien rights which the bond has replaced (e.g., imposing a 90-day notice requirement).

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