2014 | VOLUME 3

Construction In Brief

A quarterly publication brought to you by COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

Balancing Act: Amendments to Pennsylvania Mechanics' Lien Law Prioritize Open-End Mortgages Over Liens and Provide Added Protection for Residential Homeowners

By Jason A. Copley and Matthew G. Tom

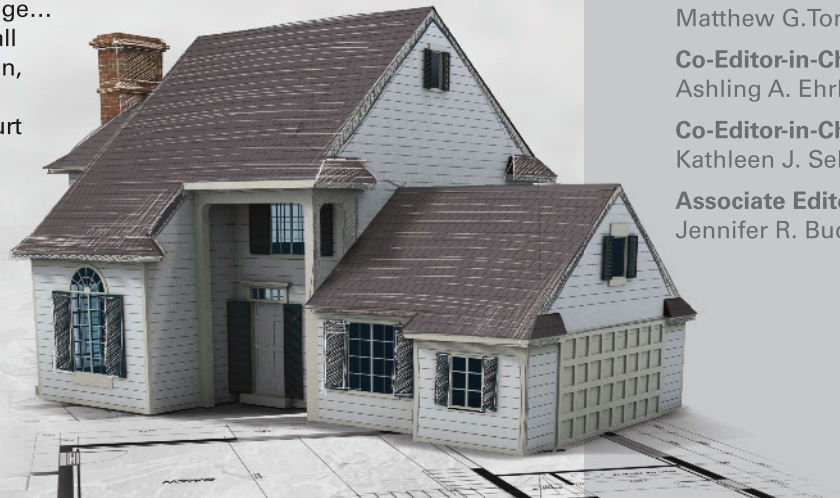
In early July, Governor Tom Corbett signed Act 117 into law, approving new amendments to Pennsylvania Mechanics' Lien Law. Act 117 amended the Lien Law in two critical ways: (1) the Act clarified that mechanics' liens are subordinate to virtually all open-end construction mortgages; and (2) the Act created a new basis, a safe harbor, for owners of residential properties to discharge mechanics' liens. The first of these two changes was made in response to the perceived shifting of power to contractors and subcontractors over owners and lenders following a recent appellate decision. The second change was made in response to the perception that contractors' unscrupulous business practices were unfairly taking advantage of, and negatively impacting, homeowners. Act 117 is intended to rebalance the relative risks and power among owners, lenders, contractors, and subcontractors. In the process, however, Act 117 has potentially tipped the scale in favor of lenders and homeowners at the expense of contractors and subcontractors.

Commerce Bank/Harrisburg, N.A. v. Kessler

The first of the changes to the Mechanics' Lien Law was precipitated by the Pennsylvania Superior Court's holding in *Kessler*. That case involved a dispute regarding the priority of a mechanics' lien, claimed by a contractor hired to build a home, relative to the open-end mortgage provided by the homeowner's mortgage lender.

The contractor argued that its mechanics' lien had priority over the lender's mortgage. The mortgage lender, however, argued that its interest had priority under a 2007 amendment to the Mechanics' Lien Law that provided that any mechanics' lien would be subordinate to an "open-end mortgage… the proceeds of which are used to pay all or part of the cost of completing erection, construction, alteration or repair of the mortgaged premises." The Superior Court rejected the mortgage lender's argument because part of the loan proceeds provided by the lender were used to pay for, among other things, closing costs, satisfaction of an existing mortgage, and tax costs.

Continued on Page 3…



IN THIS ISSUE

Contributors:

What's New

Brief Note:

Football, leaves, liens, and Super Lawyers! Thanksgiving is almost here and we've got lots of news to share. If you do residential construction work in Pennsylvania, check out our cover story about the amendments to the Mechanics' Lien Law. If you've ever sent an e-mail you regretted later, read Michael Payne's advice on page 4. Perhaps you're looking to get paid! Evan Blaker has some words of wisdom for you on page 5.

We hope you enjoy the 2014 Third Edition of Construction in Brief!

Ashling
Co-Editor-in-Chief

Kate
Co-Editor-in-Chief

Jennifer
Associate Editor

By Kerstin Isaacs

New Faces

Welcome to new Associate **Michael Metz-Topodas**, an Associate in the Firm's Construction Practice Group. Michael is a *magna cum laude* graduate of Temple University Beasley School of Law and graduate from Swarthmore College with Distinction. Before attending law school, Michael taught history and political science in private and public schools both here in the United States including, Strath Haven High School, in Wallingford, Pennsylvania, and abroad in Switzerland and Korea.

Awards

We are pleased to announce our *Best Lawyers*, *SuperLawyers* and *RisingStars*.

Four Cohen Seglias attorneys have been included in the 2015 edition of *The Best Lawyers In America*® in five different practice areas:

George Pallas – *Litigation – Construction*
John Greenhall – *Construction Law*
Marc Furman – *Employment Law Management & Labor Law Management*
Judge Gene Cohen (Ret.) – *Arbitration*

Cohen Seglias Pennsylvania 2014 SuperLawyers and RisingStars

Construction SuperLawyers
Tony Byler
Roy Cohen
Jason Copley
Shawn Farrell (*also a 2014 New Jersey SuperLawyer*)
John Greenhall
Jennifer Horn
George Pallas (*also a 2014 New Jersey SuperLawyer*)
Ed Seglias

Government Contracts SuperLawyer
Michael Payne

Labor & Employment SuperLawyers
Marc Furman
Jonathan Landesman

Construction RisingStars
Anthony Bottenfield
Matthew Gioffre
Catherine Nguyen

Cohen Seglias 2014 recipient of UTCA Larry Gardner Memorial Award

Left to right: George Pallas, Harry Chowansky, and Shawn Farrell.

On September 19, 2014, Cohen Seglias Partners George Pallas and Shawn Farrell proudly accepted the 2014 Larry Gardner Memorial Award on behalf of the Firm. Cohen Seglias received this award in recognition of its exemplary service to the Utility and Transportation Contractors Association and the construction industry.

Meet & Greet with Mayoral Candidate Ken Trujillo

Ed Seglias hosted a reception for City of Philadelphia Mayoral Candidate and Schnader Harrison Partner Ken Trujillo at the Firm.

For questions, please contact Kerstin Isaacs at kisaacs@cohenseglias.com or (215) 564-1700.

Open-End Mortgages Over Liens Provides Added Protection for Residential Homeowners

Continued from Page 1…

By Jason A. Copley and Matthew G. Tom

The Court found that the 2007 amendments only gave priority to open-end mortgages when all the proceeds of the mortgage are applied to the construction, alteration or repair of the home. The Court expressed some concern that lenders and homeowners might, under any contrary interpretation of the 2007 amendments, "manipulate the system to defeat lien rights." *Kessler* tilted the scales in favor of contractors and subcontractors.

Act 117 Prioritizes Open-End Mortgages over Liens

In direct response to *Kessler*, Act 117 expressly provides that open-end mortgages will take priority over any lien as long as at least sixty percent of the proceeds of the mortgage are used to pay all or part of the "costs of construction." The term "costs of construction" is now defined to encompass a broad spectrum of costs including: government impact fees, legal fees, finance costs, closing fees, and escrow fees, in addition to the costs of erection, construction, alteration, or repair of the mortgaged premises. This clarification to the Mechanics' Lien Law and its expansive, non-exhaustive definition of "costs of construction", will likely mean that mechanics' liens are now beneath open-end mortgages in the list of priority.

Prime Roofing LLC: "unscrupulous business practices"

The second change was made in response to the perception that contractors' unscrupulous business practices were causing residential homeowners to be unfairly surprised when subcontractors and suppliers, with whom the homeowners had no contact, filed liens on their property. One example for the revisions to Act 117 involved an out-of-state contractor taking advantage of Pennsylvania homeowners whose properties had been affected by a natural disaster. Prime Roofing LLC, a Texas company, started performing repair work in the Commonwealth after a tornado damaged multiple homes in western Pennsylvania. Although Prime Roofing completed its work on the subject homes, it failed to pay its roofing supplier. The roofing supplier, in turn, filed mechanic's liens against the properties at issue, even though the homeowners had documentation showing they had fully paid Prime Roofing. Act 117 was passed out of a concern for these homeowners, and others like them, so that homeowners would be protected from "unscrupulous business practices."

Act 117 Protects Residential Owners that have Paid their General Contractors

Concerned about the perceived unscrupulous business practices of contractors, Act 117 has also tipped the scales in favor of residential homeowners by establishing a new safe harbor against liens. Act 117 provides that no subcontractor will "have the right to file a lien with respect to an improvement to a residential property if… the owner or tenant paid the full contract price to the contractor." Further, a residential owner may discharge any lien filed with respect to an improvement to the residential property as long as the owner has paid the full contract price to the contractor. When the owner has paid only a portion of the full contract price, then the owner may seek to reduce the lien in an amount equal to what has already been paid.

The change to lien priority and the safe harbor amendment to the lien law apply to any liens filed on or after September 9, 2014, even if work commenced before the effective date of the amendments. The amendments to the Mechanics' Lien Law represent a rebalancing of the respective rights and burdens among construction lenders, owners, contractors, and subcontractors.

For the time being, it seems the scales have tilted toward lenders and owners. Accordingly, any contractors and subcontractors should remain vigilant of their rights under this new statutory regime and consider using other tools for ensuring payment. For example, if you are a subcontractor who performed work on a residential home and are owed money from a general contractor, you should consider requesting that payment from the owner be made via joint check. If you are a GC, by contrast, you should expect that disgruntled subcontractors may attempt to contact the owners directly, drawing suspicions from owners that their money is not being paid out properly, or worse, that the project may be delayed or left incomplete. GC's should make certain to keep diligent records of all payments to subcontractors in order to demonstrate, if necessary, that all subcontractors and suppliers have been paid.

Editors' Note: An additional amendment to the Lien Law was passed by the Pennsylvania Legislature on September 23, 2014 and is awaiting Governor Corbett's signature. This amendment would establish an electronic system for filing "notices of furnishing" and would require that all subcontractors file an electronic notice of furnishing as a condition precedent to asserting any lien rights. For more on this amendment, follow our blog at Constructionlawsignal.com.

Jason is Managing Partner and Matt is an Associate, both practicing in the Construction Group. They can be reached at (215) 564-1700, jcopley@cohenseglias.com and mtom@cohenseglias.com.

Contemporaneous Documentation is Not Always a Good Thing

By Michael H. Payne

There is no question that documentation is an important part in the resolution of any construction dispute. Particularly contemporaneous documents — documents that are created at the time that events occur. Quality control reports, daily logs, and timely letters all fall into the "contemporaneous" category. Another type, however, has an instantaneous characteristic that not only makes it contemporaneous, but so current as to be potentially dangerous — e-mail. This form of documentation cannot only be useful to record events virtually as soon as they occur, but it also has become a vehicle for the expression of emotions without the benefit of reflection.

Every contractor, for example, has been angered by something that another contractor, vendor, or owner has done during the performance of a construction project. If the subject of that anger or disagreement could lead to a request for additional compensation, there is often a knee-jerk reaction to put something in writing. Many of us have hurriedly drafted a letter and then, feeling better for having written it, crumpled the paper and tossed it into the nearest wastebasket. It has a therapeutic value and no harm is done. In our Information Age, however, with the ability to compose e-mail messages on our computers, iPads, and smartphones, the opportunity for reflection is gone as soon as we hit the "Send" button.

As an attorney, this often creates a serious problem when those messages are sent by a prime contractor to a sub, or by a sub to the prime. What both parties fail to recognize is that these instantaneously transmitted messages not only record past events and express current thoughts, they may also have a dramatic effect on the future outcome of a dispute. E-mail messages, and all forms of Electronically Stored Information, are just as discoverable by the other side as paper documents. What happens when the prime accuses the sub of poor workmanship and later seeks to blame the owner for providing a defective specification that actually caused the problem? That e-mail message, sent hastily to the subcontractor before all the facts were known, may become a useful document to the owner during litigation. The question, on cross-examination, will be "Isn't is true that you believed that the problem was poor workmanship by your subcontractor, and not any defect in the specifications?" If the problem really is a defective specification, the ill-advised e-mail message has provided a potential defense to the owner and has introduced uncertainty into the dispute where none may have otherwise existed.

Instantaneously transmitted messages may have a dramatic effect on the future outcome of a dispute.

The lesson is that all parties should think about the possible consequences of the emotions and feelings they are expressing in writing. There is no question that the facts, such as the working conditions, equipment, and manpower at the site, must be recorded promptly and accurately. If the accurate recording of events affects the outcome of a dispute, it probably means that justice has been done. Expressions of emotions and opinions that are not well thought-out are in a different category, however, and when conveyed in e-mail messages, they are an unwelcome byproduct of the Information Age. My advice is to be careful and think about the possible future impact of writing and instantaneously transmitting things that do not need to be said. Not every form of contemporaneous documentation is a good idea.

Michael is the Chair of the Firm's Federal Contracting Practice Group and can be reached at mhp@cohenseglias.com or (215) 564-1700.

Q&A with Michael H. Payne

Q: Cohen Seglias' Federal Contracting Group represents a number of interesting niche contractors that our readers may not be familiar with. Can you tell us more about that?

A: In addition to our federal construction and small business practices, we also work with marine contractors and contractors that work on environmental remediation. We recently had a big win for RLB Contracting, Inc. (RLB), a dredging contractor.

Q: What happened?

A: In September, Bob Ruggieri and I won a bid protest before the United States Court of Federal Claims (COFC) on behalf of RLB. The project is in Louisiana, and involves marsh creation and shoreline protection, primarily accomplished by dredging. The project was set aside for small businesses by the Natural Resource Conservation Service (NRCS). However, the NRCS applied the wrong small business size standard. The size standards applied determine whether a business is small for that particular procurement. The size standards are either determined by average annual revenue or by number of employees. In this case, the NRCS applied a $33.5 million dollar size standard, which applies to general civil construction projects. Because the project was primarily a dredging project, it should have invoked a specific exception applicable to dredging projects which, at the time, carried a lower $25.5 million size standard. The dredging size standard also carries with it a requirement that the prime contractor perform 40% of the dredging volume with its own dredge, or the dredge of another small business. Accordingly, the $25.5 million dredging size standard is more favorable to small dredging contractors in an industry typically dominated by large players.

Q: So the NRCS failed to apply an exception that would have made RLB more competitive in the bidding process?

A: Exactly. At first, we appealed the NRCS's decision to the Small Business Administration's Office of Hearings and Appeals (OHA). RLB presented evidence that the NRCS had internally estimated that more than half of the work involved dredging and also that the agency had made an improper size standard designation based on an incorrect calculation that only 10% of the labor was attributable to dredging work. Despite this evidence, OHA denied the appeal.

Q: Rather than go ahead and bid on the project under the larger size standard, you decided to file a bid protest?

A: We felt we had a very strong case and RLB had a lot to lose, not just on this project, but on future projects, if agencies were allowed to circumvent the application of the dredging exception. In a big win for our client, the COFC ruled that the NRCS' size standard designation, and the OHA's decision to uphold the designation, were incorrect as a matter of law. The Court was critical of the agency for not considering that the dredging work accounted for the greatest percentage of contract value, more than 75% according to its own internal estimate. The Court was further critical of OHA for concluding that the project did not predominantly involve dredging. As a result, the Court entered a permanent injunction and sent the matter back to the agency with instructions "to make a new determination of whether the dredging exception applies based on all available current information."

Q: Why is this decision such an important victory?

A: This decision makes it clear that federal agencies are not free to circumvent protections afforded to small business dredging contractors. Agencies cannot characterize work generally as "civil construction" when the dominant item of work is actually dredging. The dredging exception is designed to prevent brokering by non-dredging small businesses who, after receiving an award, could subcontract virtually all of the dredging work to a large dredging concern.

Three Ways to Get Paid

By Evan A. Blaker

As a commercial collection attorney, I have the benefit of seeing and analyzing credit applications from a wide array of clients. However, by the time I review the credit application, typically the account is already in arrears and whatever rights my client may have were established long before. After the fact, I am often asked by clients, "What could we have done better?" Here are three things you can do now to protect your payment rights:

Fulfilling Orders Under a Customer's Purchase Order

You receive a new order from a long-term customer for state-of-the-art switch gear, a huge high value lighting package and day-to-day supplies for a new high-rise project. Accompanying the order is the customer's purchase order, containing the "fine print" terms and conditions. Because the customer has been loyal throughout the years, you decide to fulfill the order without reading the purchase order. After your receivable ages to over 120 days, you question your customer and it responds that it has not been paid yet, so payment to you is not yet due per the terms of its purchase order.

True or false — There is nothing that you can do to protect yourself from onerous terms of a customer-issued purchased order.

The Balance Due is Small

You have a customer that owes a balance but it is relatively small.

True or false — There is nothing that you can do other than write off a receivable that is a small amount.

Your Customer is Having Difficult Financial Times

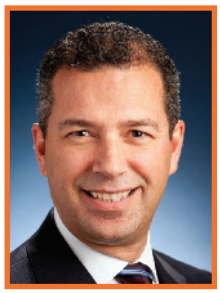
You have a customer that is not paying its bills and says that the company is failing and is about to go out of business.

True or false — Since the customer is going out of business, there is nothing that you can do to collect the balance owed.

Answers on Page 7…

What Did I Agree to Arbitrate and Who Decides?

By George E. Pallas and Matthew L. Erlanger



It is common for construction contracts to include an arbitration provision because of the perceived advantages: cost, speed, privacy, finality, and the ability of the parties to choose an arbitrator with experience in the construction industry. Despite the intent to arbitrate, sometimes the parties are redirected to the courts because of different interpretations of the arbitration provision and the contract. For example, the parties may not agree on whether the dispute is within the scope of the arbitration agreement; they may not agree on whether a contract was formed; or they may not agree on the validity or enforceability of the arbitration provision or the contract as a whole. When those issues arise, the first question is "Who decides — the arbitrator or the court?" Who decides this issue may have an impact on the determination of the underlying action.

General Rules Concerning Arbitration

Assuming your contract contains an arbitration provision, challenges to the validity and enforceability of the contract will be decided by the arbitrator. All other disputes concerning arbitration provisions are for the court, unless there is "clear and unmistakable" evidence that the parties agreed to submit them to arbitration. Whether there is "clear and unmistakable" evidence depends on the precise language of your arbitration provision.

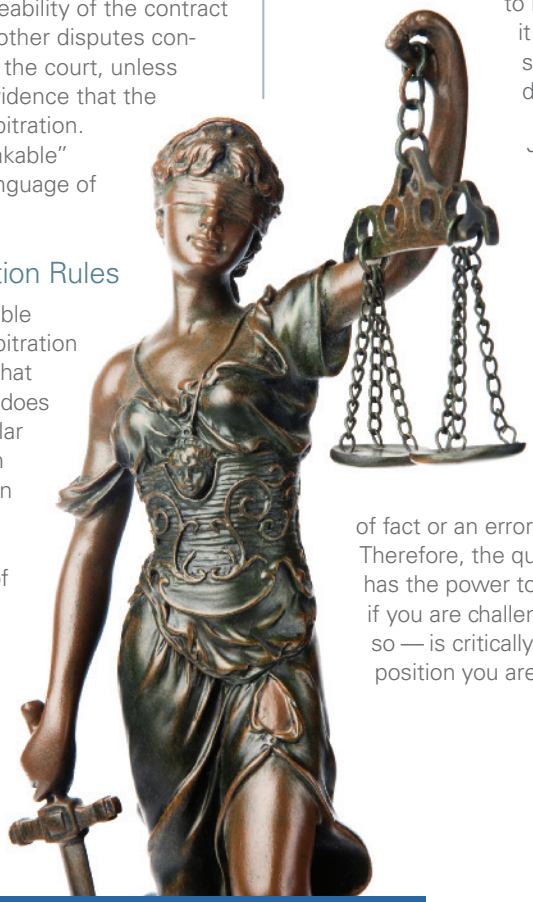
American Arbitration Association Rules

At first glance, "clear and unmistakable evidence" would appear to be an arbitration provision which expressly provides that the arbitrator either has the power, or does not have the power, to make particular decisions. However, most arbitration provisions are not that precise, and in many cases, parties will utilize "standard-form" contracts — like those prepared by the American Institute of Architects. AIA contracts contain general arbitration provisions which typically provide that disputes are to be decided "by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association currently in effect." Although that provision is fairly standard, it may have a significant effect on whether or not your particular dispute is decided by an arbitrator or a court.

One of the AAA Rules that the standard AIA arbitration provision includes is Rule R-9, which provides that "the arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement." Although Pennsylvania and New Jersey's appellate courts have not yet ruled on whether this language is enforceable, many other courts, including federal courts based in Pennsylvania and New Jersey, have ruled on the language and have determined that it meets the "clear and unmistakable evidence" standard. Therefore, if your contract incorporates the AAA Rules, then there is a good chance that you have agreed that an arbitrator — and not a court — will decide whether your dispute is within the scope of the arbitration provision, whether your arbitration provision is valid or whether you have even formed a contract.

What Difference Does it Make?

Although it may seem somewhat inconsistent to agree to an arbitration provision in your contract, but allow courts to become involved in your disputes, it is an important decision that may significantly affect the resolution of disputes under your contract.



Judges — unlike arbitrators — are strictly bound by the law and may be overruled by a higher court if the law is not followed. On the other hand, in Pennsylvania, an arbitrator's decision may only be vacated if a party is denied a hearing or if fraud, misconduct, corruption or other irregularities caused an unjust, inequitable or unconscionable award. Generally, an arbitrator's decision is not subject to reversal if he or she made a mistake of fact or an error of law in rendering an award. Therefore, the question of whether an arbitrator has the power to decide your dispute — particularly if you are challenging the arbitrator's ability to do so — is critically important, regardless of the position you are advancing.

If you have incorporated the AAA Rules in your arbitration provision, then you should expressly exclude Rule R-9.

In these situations, it is generally preferable to allow the courts to decide if the arbitrator has the power to decide your dispute, and whether or not your arbitration provision is valid under the law. If you have incorporated the AAA Rules in your arbitration provision, then you should expressly exclude Rule R-9. If your arbitration provision does not incorporate the AAA Rules, then you should consider expressly stating that the arbitrator does not have the power to rule on his or her own jurisdiction, and does not have the power to decide the existence, scope, or validity of the arbitration provision, but, instead, those decisions are for a court of competent jurisdiction to decide.

Although the language of arbitration provisions often flies under the radar, such language is critically important because it, along with the law, defines your rights and obligations. Knowing how your rights and obligations are affected by your contract language may be critically important to the ultimate resolution of a dispute. The lawyers at Cohen Seglias Pallas Greenhall & Furman, P.C. are ready to provide you with the legal advice you need to make those decisions.

George is a Partner and Matt is an Associate, both practicing in the Construction Group. They can be reached at (215) 564-1700 and gpallas@cohenseglias.com and merlanger@cohenseglias.com.

Three Ways to Get Paid
THE ANSWERS

Continued from Page 5...

Fulfilling Orders Under a Customer's Purchase Order

Answer: False

Oftentimes goods or materials are provided after your customer provides a purchase order. Did you read the purchase order? Did you read the "fine print"? Most often, the answer to those questions is "no." The problem is that all of the powerful provisions in your credit application are trumped by the inconsistent provisions of the purchase order. For example, your terms require payment within 30 days of invoice, but your customer's purchase order requires payment only if your customer is paid by its customer. This type of provision is well-known in the construction industry as a "pay-if-paid" provision. So long as the provision has language that makes it clear that you bear the risk of non-payment to your customer, these clauses will be enforceable and prevent you from recovering until your customer has been paid by its customer for the materials you supplied.

To provide yourself with the best possible argument and protection from the nasty provisions of your customer's purchase order, you could have a provision in your credit application that indicates the terms and conditions of the credit application take priority over any inconsistent terms contained in other customer-provided documents. In addition, when you receive a customer-issued purchase order, send it back with a note, to be signed by the customer, agreeing that if the purchase order's terms are inconsistent with and/or in conflict with the terms of your credit application, the terms of the credit application shall apply.

The Balance Due is Small

Answer: False

You can and should have an attorney's fees or costs of collection provision in your credit application. Having such a provision obligates your customer to pay your counsel fees and costs in the event you undertake collection activities. Such a provision negates the often-used strategy to negotiate based on the theory that you should compromise the value of your payment demand in recognition of the expected cost of collection litigation. Note, however, there are certain laws that allow for the recovery of counsel fees. Such laws do not always apply, are often narrow in scope, or give a judge discretion whether to award such fees. Notwithstanding this, an attorney's fees or costs of collection provision still gives you greater leverage and assigns more risk to the customer in the event of payment default.

Your Customer is Having Difficult Financial Times

Answer: False

You can and should have a personal guaranty provision in your credit application. In cases where your customer is not paying, often it is because the customer is having its own financial issues. Instead of you financing your customer's trade debt, a personal guaranty apportions liability to your customer's principal(s) in the event that the company defaults. In my experience, when the principal(s) of the business have personal liability that is independent from the company's exposure, you will have far greater payment leverage.

Evan is a Partner in the Commercial Litigation Practice Group. He can be reached at (215) 564-1700 or at eblaker@cohenseglias.com.

2014 | VOLUME 3

Construction In Brief

A quarterly publication brought to you by COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

IN THIS ISSUE

Follow Us...

Be sure to visit our two construction-related blogs for insights and information on current and emerging developments affecting the construction industry and federal construction contractors.

constructionlawsignal.com ▪ fedconblog.com

Follow us on Twitter @CohenSeglias and @FedConLaw Like us on Facebook

Use your smart phone to visit our homepage. Get the free app for your phone at http://gettag.mobi

COHEN SEGLIAS
PALLAS GREENHALL & FURMAN PC

Cohen Seglias Pallas Greenhall & Furman PC has deep roots in the Mid-Atlantic region and a long-standing reputation for putting the interests and needs of our clients first. The Firm advises and counsels businesses and individuals in a broad range of legal services.

United Plaza, 19th Floor ▪ 30 S. 17th Street
Philadelphia, PA 19103

cohenseglias.com ▪ 215.564.1700

Pennsylvania ▪ New Jersey ▪ New York ▪ Delaware ▪ Maryland ▪ West Virginia

PRESORT
FIRST CLASS
U.S. POSTAGE
PAID
UMC