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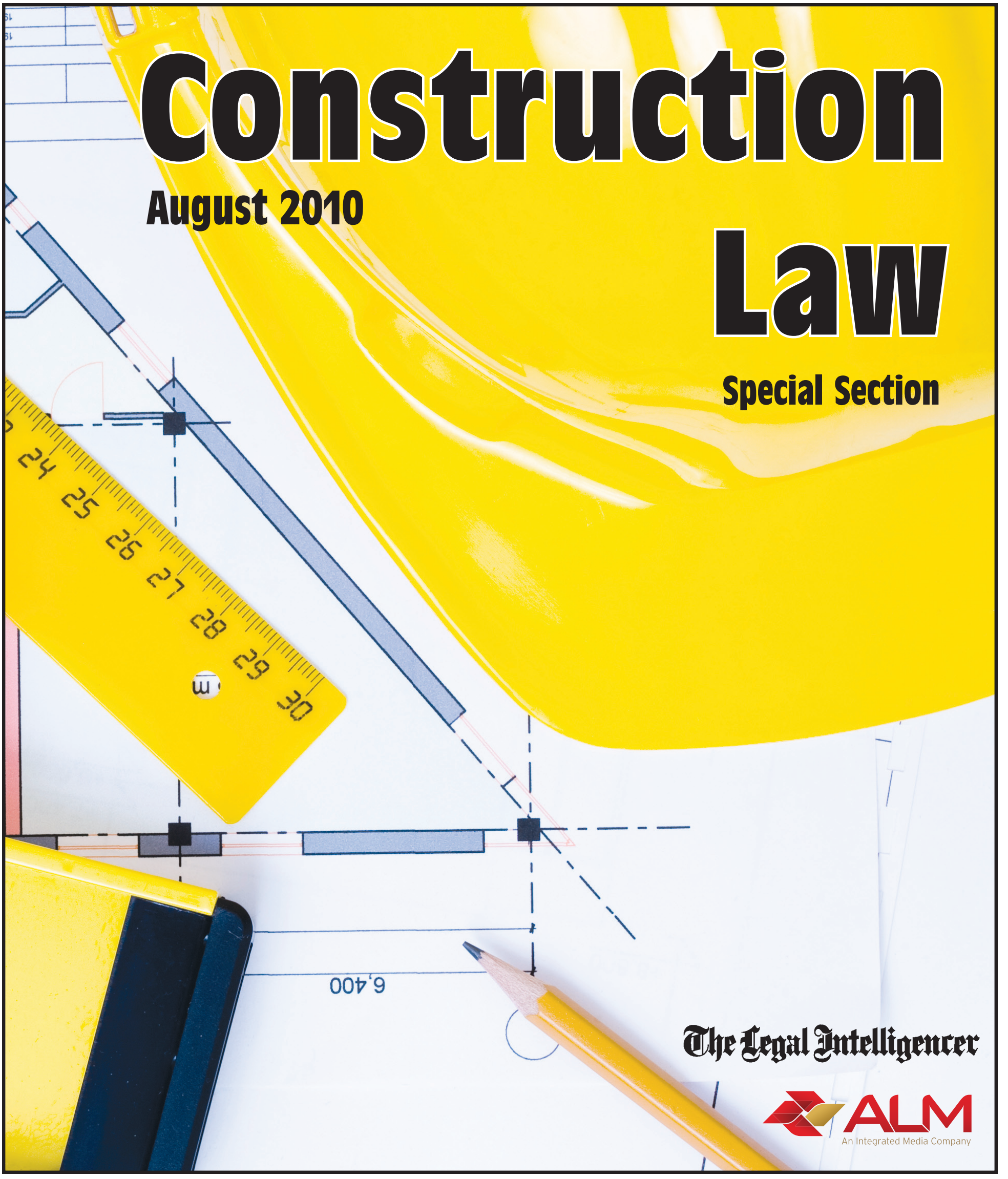

The Legal Intelligencer

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The Effects of Geographic and Substantive Shifts in Business

BY JENNIFER HORN
Special to the Legal

For an increasing number of construction-related entities, survival in the current economy has meant expansion of both geographic and substantive work area comfort zones. Branching out in this manner can result not only in a broader client base, but, as when a joint venture is involved, may lead to a mutually beneficial new business relationship.

In crossing state borders and embracing new areas of work, however, both clients and the practitioners who advise these entities must be mindful of a multitude of legal pitfalls that can have a significant impact on the parties' rights and responsibilities.

SHIFT IN GEOGRAPHY

In the search for good work, some construction entities are expanding geographically to include projects in other states. In doing so, many overlook the professional licensing requirements of the new state that, in some cases, impact an unlicensed contractor's ability to enforce a contractual right to payment in the event of a dispute. Such entities must be advised to adhere to the licensing requirements of each state in which work is performed, if possible, before the contract is signed to avoid embarrassment and/or curtailment of legal rights.

In addition, the requirements and consequences of a company's compliance or failure to comply with Minority-Owned Business Enterprises (MBE), Women-Owned Business Enterprises (WBE) and Disadvantaged Business Enterprises (DBE) participation guidelines and regulations may also differ across state lines despite the uniform federal regulations that guide the administration of these regulations. Thus, even though similarities exist, the administration of MBE, WBE and/or DBE guidelines and the consequences to a contractor of even inadvertent MBE, WBE and/or DBE misrepresentations can vary from state to state. A contractor performing work in a different jurisdiction would be wise to understand how the particular state administers MBE, WBE and/or DBE issues and recognize that expectations and consequences may differ depending upon the jurisdiction.

Perhaps most obvious, contractors performing work in a new state must be cognizant of important statutory and legal differences that impact lien and bond rights. Such contractors should seek assistance before performing work in a new jurisdiction. In some states, a careless supplier may unknowingly waive its bond rights even before delivering materials to the project work site. Lien and bond deadlines, of course, are often strictly construed and vary significantly depending upon the jurisdiction.

Practitioners should also be prepared to advise construction clients on the jurisdictional differences in the permissibility of particular contract provisions, including liquidated damages provisions, indemnification provisions and other standard contractual provisions. The provisions of state payment acts and trust fund acts, as well as the relief afforded, also vary widely from state to state.

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Likewise, the impact of an owner's bankruptcy filing on a contractor's lien rights and ability to recover payment is not uniform across state lines. Distinctions also emerge when one compares the enforceability of pay-if-paid and pay-when-paid clauses, lien waivers, and no damage for delay clauses throughout jurisdictions. These are just a few examples of the myriad issues construction entities should be cognizant of before performing work and before a construction contract is executed.

For design professionals accustomed to practicing in a particular state in which certain form AIA contracts are generally utilized, performing work in a neighboring state can also create significant issues if they do not carefully review the contract's fine print. Such contracts may differ substantially from the modified AIA documents to which these design professionals are accustomed and dramatically impact the administration of the contract and ability to get paid for the design services rendered. Although similar in appearance, these contracts must be scrutinized and the force and effect of even nuanced changes understood.

Design professionals working in new geographic areas should also be mindful of whether the principles of *Bilt-Rite Contractors Inc. v. The Architectural Studio* and its progeny are applicable or unrecognized in the jurisdiction at issue. Of course, professional licensing requirements must be satisfied when work is performed in a neighboring state. Understanding potential causes of action before problems arise can not only guide the work of the design professional, but factor into how a firm implements a geographic expansion plan.

SHIFT IN SUBSTANTIVE FOCUS

Although many contractors are interested in shifting their business from the private into the federal sector, such attempts are fraught with peril in light of the highly specialized federal regulations governing such work and the fact that an examination of a contractor's prior past performance on other federal jobs is often necessary before new work is awarded.

Nevertheless, many contractors are shifting the substance of their new work from the private to the public sector. Funding streams, fueled by government stimulus money — as well as the proliferation and ease of joint venturing as a means of expanding one's business — have facilitated this change. For contractors that have never performed such work, federal contracting consulting groups can assist with the joint venturing, bidding, and contract review process to ensure compliance with all regulations.

SHIFT IN STANDARD BUSINESS PRACTICES

As a result of the trends described above, smart construction entities and the construction law practitioners who advise them strive to adhere to standard business practices that facilitate and support changes in geography and substance.

Such practices include, but are not limited to, the following:

• Reviewing, signing and maintaining a copy of the entire project contract. This includes all of the general conditions, specifications, integrated drawings (if applicable), addenda, administrative procedures, state regulatory codes and any other document identified as part of the project contract or incorporated into the contract by reference;

• Maintaining a copy of all bonds related to the project and understanding any and all applicable notice provisions set forth in the bonds as well has how one's bond rights can be preserved before performing work on the project;

• Understanding which state's law applies to the project and, accordingly, which trust fund acts, state payment acts, bond acts and/or mechanic's lien acts apply;

• Understanding the force and effect of key contractual provisions as interpreted by recent case law in the relevant jurisdiction;

• Keeping detailed records of all project activities and, when problems arise, documenting these issues contemporaneously; and

• Understanding the applicable claims/dispute resolution procedure including, but not limited to, all applicable deadlines.

As referenced above, some entities have found success by engaging in joint ventures with others who possess detailed knowledge of the particular region and/or area of work. Others achieve geographic and substantive expansion by affiliating with and/or opening a branch office in the new market and, in doing so, benefit from experienced local talent.

In any event, the best business results are achieved when construction entities shift their standard business practices to account for a new jurisdiction's regulations, rules and laws and take care to understand the nuanced but important differences that exist across borders and practice areas before performing the work. •

Properly Administering Arbitration in Construction Disputes

BY M. MELVIN SHRALOW
Special to the Legal

Disputes arising from construction projects — often involving multiple issues, claims and parties — can greatly benefit from the efficiencies and economies of a properly administered arbitration process. But in order to gain the advantages of a process tailored to the needs of the parties, there must be properly drafted provisions in all related contracts that commit the various participants to the same proceedings.

It is crucial that there be a provision in all contracts relating to the project — starting with design professionals such as architects and structural engineers, and including companies providing preliminary testing, the general contractor, all subcontractors and the suppliers of major components of the project — that is unambiguous and consistent.

The benefits of a well-managed arbitration include having a knowledgeable professional as the decision maker, efficient scheduling tailored to the particular circumstances of the case, efficiently limited discovery that permits what is necessary but eliminates "fishing expeditions," hearings that are flexible in seeking to determine the issues without undue deference to rigid rules of evidence, and prompt, reasoned decisions of the issues presented.

Many of the efficiencies of arbitration will be lost or diluted if there are omissions or inconsistencies in the arbitration clauses, because court proceedings to compel or prevent arbitration will result in the delays and expense that arbitration is intended to avoid.

In drafting a proper arbitration provision, counsel should be aware both of federal and state law applicable to the project and the contracts. The Federal Arbitration Act (FAA) has applicability consistent with the full reach of the Commerce Clause of the U.S. Constitution. Pennsylvania has adopted the Uniform Arbitration Act (UAA), but has not adopted the Revised Uniform Arbitration Act (RUAA). Each statute can affect the arbitration process. The process also will be significantly affected by and governed pursuant to the rules, if any, of an organization chosen to be the provider of arbitration services, such as ADR Options, the American Arbitration Association, JAMS, CPR or others. Knowing the rules of the provider, if one is chosen, is important.

The essential elements of a properly drafted arbitration provision will include the following:

• An agreement to arbitrate;

• All disputes arising under or in connection the contract and the project;

• Whether in contract or in tort;

• Including class issues, if any;

• Specifying the location of the arbitration;

• Specifying the manner of choosing the arbitrator or arbitrators;

ADR continues on **CL7**

Court Restricts Use of Best Value Procurement in Contractor Selection

BY MICHAEL P. SUBAK AND JOSEPH T. IMPERIALE
Special to the Legal

Federal and state government contractor selection continues to be a hot-button political issue as public agencies grapple with the best bidding and delivery systems to maximize taxpayer dollars.

Until recently, and for more than 100 years, public agencies have been awarding construction contracts to the low bidder. Proponents of this practice point out that awarding to the low bidder protects the public fisc and avoids favoritism from creeping into the procurement process. The detractors of the low-bid process argue that low-bid contracts invariably sacrifice quality to price or attract contractors that need to assert claims to generate any profit.

In recent years, both federal and state agencies have employed various alternative procurement practices, including "Best Value Procurement." In many best value procurements, price is just one of many factors that is reviewed by the procuring agency in assessing a contractor's sealed proposal. This practice has received its fair share of criticism, as unsuccessful bidders question the subjective nature of the process. For its part, Pennsylvania's Department of General Services (DGS), the agency that oversees procurement of goods and services, has moved from strictly employing traditional competitive bidding to also using the alternative process of competitive sealed proposal bidding.

Recently, in *PA Associated Builders and Contractors Inc. v. Commonwealth Department of General Services*, the Commonwealth Court restricted the circumstances under which the commonwealth may use the competitive sealed proposal method. This article identifies the different contractor selection methods in Pennsylvania, reviews the recent Commonwealth Court opinion, and assesses the potential impacts flowing from the *PA Associated Builders* case.

TRADITIONAL COMPETITIVE BIDDING V. BEST VALUE PROCUREMENT

Before 2005, the commonwealth used competitive sealed bidding to award construction contracts. According to the *PA Associated Builders* opinion, "This process provided that the award of the contract went to the lowest responsible bidder in order to ensure fairness while also guarding against fraud and favoritism to all those bidding."

Under competitive sealed bidding, discretion is limited to a determination of bidder responsibility, whether a bid is responsive and whether all bids should be rejected. Otherwise, the project is awarded to the lowest bidder.

Although not widely used before 2005, Section 513 of the Procurement Code allows for competitive sealed proposals when competitive bidding is either not "practicable or advantageous" to the commonwealth. This practice, commonly referred to as the RFP method of contractor selection or Best Value Procurement, allows the procuring agency to evaluate the proposal.

In the best value format, the proposal consists of the following elements:

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- A lump-sum amount for which the contractor proposes to perform work;
- A technical submission that seeks to establish the contractor's ability to perform the work, as more fully described in the RFP; and
- A sealed Disadvantaged Business Enterprise submission that identifies minority-, woman-owned or small disadvantaged business subcontractor participation with each contractor.

A proposal evaluation committee, consisting of five voting members appointed by DGS, reviews the technical submission and awards points for each element of the technical proposal. The contract is awarded based on the cost (60 percent), a technical score on the competency to perform the work (30 percent), and a disadvantaged business score (10 percent).

RESTRICTIONS

A recent Commonwealth Court opinion limits the scenarios under which the RFP method of contractor selection may be employed by the commonwealth. In *PA Associated Builders*, the court addressed the use of best value procurement versus traditional competitive bidding.

In *PA Associated Builders*, DGS used the RFP process to select a contractor for the renovation of the Foster Union Building at Cheyney University. The court analyzed when the RFP process, as opposed to competitive bidding, is appropriate.

The commonwealth's Procurement Code provides, "When the contracting officer determines in writing that the use of competitive sealed bidding is either not practicable or advantageous to the Commonwealth, a contract may be entered into by competitive sealed proposals."

The court sought to clarify what level of particularity is needed when a contracting officer determines in writing that the use of competitive sealed bidding is either not "practicable or advantageous."

It stated: "To meet the 'particularity' standard, it is not enough for the contracting officer to merely state the competitive bidding process in not 'practicable or advantageous,' that use of RFPs is 'better' in general or to just give some vague reasons why it chose to use an RFP on a particular project over the default competitive bidding process. Rather, the determination must contain a detailed explanation of why on a particular contract the RFP process has to be used. For that explanation to satisfy the particularity standard, the RFP determination must explain the contracting agency's decision so that a prospective bidder has sufficient information to make an informed decision of whether to file a bid protest.

"Moreover, absent a hearing, the written determination to use the RFP process should be sufficient for meaningful judicial review if an appeal is taken. Most importantly, it is necessary to give the particular reasons why the competitive sealed proposal process must be used to insure the integrity of the bidding process so that the public can know that the RFP process is being used to get the 'best value' for public money expended on the project and not to award the contract to the 'best buddy.'

"A determination that contains a sufficient level of particularity also satisfies ABC's members' due process rights because the reasons given are now sufficient for it to file a bid protest. If the written determination is sufficient to explain DGS' reasons, then it also gives potential bid protestors a sufficient basis to file a bid protest. Similarly, if the reasons given in the written determination show that there was not an abuse of discretion in using RFP procedure, it necessarily follows that the hearing officer did not abuse his or her discretion in denying a hearing on the bid protest."

In applying this standard, the court turned to the project at issue. DGS issued a "Determination to Use the Request for RFPs" dated April 11, 2005, stating:

"The use of the standard competitive sealed bid process for the renovation of Foster Union would not be advantageous to the Commonwealth. Competitive sealed proposals are a more practical method of procurement since this will allow Proposers flexibility in developing their proposals to address their experience with this type of work and the ability to complete coordinated construction in a timely manner. In addition to expediting the process, this method will be more advantageous by allowing the Commonwealth the ability to consider criteria other than cost in the award process. The prime contracts to be awarded, if any, will be agreed-upon sum awards reflecting the costs submitted in the proposals."

Accordingly, the court found the "specific" reasons that DGS employed the RFP method were that RFPs allowed DGS to select a contractor with experience in the type of work involved and the ability to complete the construction in a timely manner, and would allow DGS to consider criteria other than costs.

In evaluating the specific reasons provided by DGS, the court recited DGS's description of the project found in the bid package:

RFP continues on **CL7**

Pennsylvania's Statutory Employer Defense: A Primer

BY DENNIS P. ZIEMBA AND HEATHER RUSSELL FINE
Special to the Legal

General construction contractors in Pennsylvania have a unique defense against tort claims brought by workers who claim they were injured while on the job.

Most employers are already aware that the Pennsylvania Worker's Compensation Act provides the exclusive remedy against them for an employee's tort claims arising out of work-related injuries. Under the act, an employer is liable to pay benefits to employees injured on the job, regardless of fault. In return, the employer is protected from common law tort liability for those work-related injuries.

This act also provides the basis for a lesser-known method of defending against an employee's claims for injuries sustained at work. As most practitioners are aware, Section 302(b) of the act imposes "primary responsibility" upon general contractors for the payment of benefits to the employees of a subcontractor. In Pennsylvania, however, the provisions of the act are not just applicable to an employer and its direct employee. The statutory employer doctrine also provides immunity from tort liability to an employer in connection with a subcontractor's employee, or an y other worker considered to be a "statutory employee."

In essence, the Pennsylvania statutory employer doctrine allows general contractors to stand in the shoes of the injured party's employer and grants to those contractors absolute immunity from common law claims brought as a result of injuries sustained by an employee of their subcontractor.

The additional immunity conferred upon employers by the statutory employer doctrine arises out of Section 203 of the act, which specifies:

"Any employer who permits the entry upon the premises occupied by him or under his control of a laborer or an assistant hired by employee or contractor, for the performance upon such premises of a part of such employer's regular business entrusted to that employee or contractor shall be liable for the payment of such compensation to such laborer or assistant unless such hiring employee or contractor, if primarily liable for the payment of compensation, has secured the payment thereof as provided for in this act. Any employer or his insurer who shall become liable hereunder for such compensation may recover the amount thereof paid and any necessary expenses from another person if the latter is primarily liable therefore."

Arguments for statutory employer immunity are most often found in the construction industry, when a general contractor is hired by a building owner to perform work, and that general contractor hires a subcontractor, who in turn hires its own employees.

The statutory employer doctrine, and its broad grant of immunity, is narrowly construed by courts in Pennsylvania. In order to overcome this hurdle, attorneys must defeat the notion articulated by some that the statutory employer doctrine is not only bad policy, but also contrary to "basic tenets of American law."

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Despite its embattled history, the statutory employer doctrine is deeply rooted in Pennsylvania jurisprudence. In its first comprehensive discussion of the statutory employer doctrine, the Pennsylvania Supreme Court held in 1930's *McDonald v. Levinson Steel Co.* that in order to qualify for immunity from tort liability under the act, a general contractor must first clearly establish the existence of the following five elements:

- It is under contract with an owner or one in the position of an owner;
- It occupies or controls the premises;
- It made a subcontract(s) with another entity;
- Part of its regular business was entrusted to such subcontractor(s); and
- The injured party was an employee of the subcontractor(s).

A party seeking application of the statutory employer doctrine must prove each of the elements set forth above; attempts to apply the doctrine will be highly scrutinized by the court, as seen in 2002's *Peck v. Del. County Bd. of Prison Inspectors*. Due to the fact-specific nature of the inquiry, there has been much litigation in Pennsylvania with regard to the exact definitions of those terms and the proof required to confer immunity status.

CONTRACT BETWEEN EMPLOYER AND OWNER

The term "employer" as used in the first element of the statutory employer requirement is considered by Pennsylvania courts to be synonymous with that of a general contractor, according to *Fonner v. Shandon Inc*. An employer may satisfy this element of the statutory employer test by providing evidence of a written building contract between it and the owner of the building or jobsite where the work is performed.

Under the statute however, the test does not hinge on the ownership of the jobsite. The general contractor need not show it contracted with the actual owner of the building or jobsite, as long as it contracted with an entity in the position of an owner. For example, this element of the statutory employer test can be satisfied if the general contractor entered into a renovation contract with an authorized lessee of the building, as seen in *Pozza v. U.S.*

PREMISES OCCUPIED

The statutory employer doctrine does not require an employer to both occupy and control the jobsite in question in order to qualify for tort immunity. A general contractor can satisfy this element of the statutory employer doctrine with evidence that it either occupied the jobsite or was in control of the jobsite, according to *Emery v. Leavesly McCollum and John Rich Co. Inc*.

First, acording to *Kelly v. Thackray Crane Rental Inc.*, a general contractor may establish it effectively "occupied" the premises when its supervisor was present at the site on a daily basis and when its employees were regularly present on the premises at the same time as the subcontractor's employees. The general contractor may similarly satisfy this element by showing it maintained and utilized an office, trailer or similar location on the jobsite for the duration of the project.

Second, a general contractor is not required to establish it provided day-to-day, detailed instructions to its subcontractors or their employees regarding how to do their jobs in order to maintain "control" of the site. Nor is it necessary for a general contractor to show it had exclusive control of the project or worksite.

An entity seeking the protections of the statutory employer doctrine must be able, however, to show more than just the mere right to control the premises, according to *Al-Ameen v. Atlantic Roofing Corp.* An employer can satisfy the "control" element of the statutory employer with evidence of an on-site superintendent who coordinated the work of the various subcontractors, who was responsible for overseeing the entire project, and had responsibility and authority to direct, manage or operate the construction project where the injury occurred, as per *Emery*.

SUBCONTRACTS

A general contractor seeking immunity under the statutory employer doctrine must also show it had sufficient vertical contractual privity under Pennsylvania law.

A party attempting to meet this element of the doctrine often does so with evidence of a written subcontract between the general contractor and the subcontractor. However, Pennsylvania courts do not require proof of an immediate contractual relationship as a prerequisite for statutory employer immunity, according to *Lascio v. Belcher Roofing Corp*. Instead, courts will find that an employer has met its burden with evidence of a vertical "chain" of contracts. For example, courts have found the requisite subcontract when a property owner contracted with a general contractor, and that general contractor in turn contracted with a subcontractor, who then contracted with another sub-subcontractor.

Statutory *continues on* **CL7**

Owners Beware: *Trevdan Building Supply v. Toll Brothers Inc.*

BY ANDREW D. KLEIN AND WILLIAM L. CARR
Special to the Legal

Once upon a time, there was scarcely a fairer place than Pennsylvania in which to be an owner of a construction project. While owners were responsible to the general contractors with whom they contracted directly, in the absence of unusual circumstances, owners were not responsible for the sins of those with whom they contracted, and could not, generally speaking, be liable to those subcontractors, including suppliers, with whom they had no privity of contract.

With one notable exception, unless an owner specifically identified a subcontractor as a third-party beneficiary of its contract with the general contractor, or misled a subcontractor by, for example, falsely promising to make good on missed payments, an owner — like the parties to any other type of contract — was liable only for its own misdeeds and not the misdeeds of those with whom it contracted.

THE MECHANICS' LIEN LAW

The exception, of course, is one that is unique to the world of construction: the mechanics' lien. Under the Mechanics' Lien Law of 1963, the Legislature provided subcontractors with the extraordinary ability to seek redress directly against an owner for the payment failures of a general contractor with whom the owner contracted.

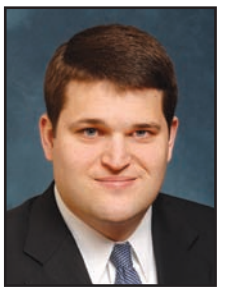
So long as the subcontractor strictly complied with certain procedural (largely notice) requirements, upon receipt of formal notice of the lien claim and upon an additional 30 days notice to the general contractor, the lien law empowers an owner to, among other things:

- Withhold future payments from the general contractor;
- Require the general contractor to settle or discharge the lien claim;
- Defend the owner against such claim; or
- Pay the claim of the subcontractor directly (regardless of whether the owner had such right under its contract with the general contractor).

Prior to 2007, however, the lien law had one significant drawback — one that was virtually unique to Pennsylvania — in most circumstances, owners could require their general contractors to file lien waivers, binding on all subcontractors, in advance of the performance of any work on the project.

Although subcontractors were free to pass on any work for which an owner required advance lien waivers and had the full panoply of remedies at their disposal against the contractors with whom they contracted, second-tier parties had very little recourse to pursue owners for the payment failures of general contractors.

After much lobbying, however, the Legislature closed this loophole in January 2007 by amending the lien law, disallowing advance lien waivers on all non-residential construction projects in the absence of a payment bond. Thereafter, in addition to all of their rights against those with whom they enjoyed privity of contract, under the amended lien law subcontractors could pursue owners directly in all non-residential construction projects. And while owners were subject to liability to subcontractors with whom they did not contract, owners knew that if they received no notices within six months of the performance of a subcontractor's work on a project, they should be safe from litigation by such parties.



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Moreover, even if lien claims were properly filed, the lien law provided owners with the ability to shift liability for, and the defense of, such claims to their general contractors and/or to pay the liening subcontractors directly, regardless of the terms and prohibitions of the contract between the owner and the general contractor.

Enter *Trevdan Building Supply v. Toll Brothers Inc.*

THE CASE

In *Trevdan*, Toll Brothers entered into a contract with Houston Drywall Inc. to perform drywall work on two of its construction projects. Pursuant to the contract, Houston was not entitled to final payment until it furnished Toll Brothers with a "full and complete release of liens" as well as "satisfactory evidence" that all of Houston's suppliers had been paid in full. And in the event that Houston failed to pay its suppliers, in addition to withholding payment to Houston, Toll Brothers had the right, but apparently not the obligation, to pay such suppliers directly. Houston, in turn, entered into a contract with Trevdan Building Supply to supply Houston with building materials for the project.

On Sept. 27, 2004, Houston sold its receivables under its contract with Toll Brothers to Gulf Coast Bank and Trust Company. On Sept. 2, 2005, Houston ceased operations and immediately thereafter, Trevdan demanded that Toll Brothers satisfy the balance of what Houston owed to Trevdan for materials supplied.

Toll Brothers refused to distribute funds to Trevdan, and on Oct.11, 2005, without filing or pursuing a mechanics' lien claim, Trevdan sued Toll Brothers directly on equitable lien, unjust enrichment and third-party beneficiary theories. On Nov. 17, 2005, Houston filed for bankruptcy protection. On Feb. 17, 2006, after obtaining relief from the automatic stay, Gulf Coast commenced its own action against Toll Brothers, seeking payment for Houston's outstanding invoices.

Meanwhile, on Jan. 10, 2006, the trial court granted Toll Brothers's petition for interpleader, accepting a payment from Toll Brothers of $118,934 into the court for distribution to the appropriate parties. Ultimately, the trial court divided the interpleaded funds, awarding Gulf Coast $89,194; Trevdan $14,740; and Toll Brothers $15,000 for attorney fees. Trevdan appealed and, by a divided panel, the Superior Court reversed.

Extending equitable subrogation rights traditionally reserved for sureties that stepped in and actually paid subcontractors following payment defaults by general contractors, the Superior Court found not only that Trevdan could directly sue Toll Brothers, but that it was entitled to full payment from Toll Brothers.

Curiously, even though Toll Brothers had no contractual obligation to pay Houston's suppliers upon non-payment by Houston, the Superior Court found that Toll Brothers acted unreasonably in withholding payment from Trevdan for two months prior to Houston's bankruptcy — even though Toll Brothers had paid over the disputed funds to the court via its interpleader petition.

More curious still, had Trevdan pursued a mechanics' lien claim against Toll Brothers, Toll Brothers would have been statutorily required to wait at least 60 days before having the right, but not the obligation, to pay Trevdan; 30 days following service of formal notice by Trevdan; and 30 days more following notice to Houston from Toll Bothers.

Lastly, the court reversed a statutorily required award of attorney fees to Toll Brothers (as an interpleader) finding that its allegedly unreasonable 60-day payment delay trumped the statute. In other words, instead of rewarding Toll Brothers's decision not to contest its payment obligation to either Houston or Trevdan, or both, the court penalized Toll Brothers and potentially future owners on other projects.

CONSIDERATIONS WARRANTED

Prior to *Trevdan*, in the absence of being named a third-party beneficiary to a general contractor's agreement with an owner and without the owner having engaged in some sort of deceptive conduct, a second-tier party's only remedy against an owner was through the mechanics' lien process. Via *Trevdan*, the Superior Court appears to have created a new basis for which a subcontractor can pursue an owner directly for the sins of the general contractor without the need to pursue (and apparently in addition to pursuing) a mechanics' lien claim. Not only does the decision upset the statutory scheme established by the Legislature, it also threatens to multiply future construction-related litigation.

First, in providing subcontractors with a second direct remedy against an owner, the decision is certain to generate additional litigation. Under Rule 1657 of the Pennsylvania Rules of Civil Procedure, a liening party may not join any other causes of action with an action to obtain judgment on a mechanics' lien claim. To cover all bases, many, if not most, second-tier parties who sue to enforce mechanics' lien claims will commence separate litigation against an owner to enforce their so-called equitable lien rights under *Trevdan*.

Second, the decision appears contrary to the scheme set forth by the lien law — and by the language in most construction contracts (including the contract between Toll Brothers and Houston) — that an owner is permitted, but not obligated, to pay a subcontractor directly upon proper notice to the general contractor. The owner's permissive, but not mandatory, right exists for a reason: to give the general contractor either a chance to cure or to dispute its subcontractor's right to payment in the first instance.

While apparently not the case in *Trevdan*, one can certainly imagine a situation in which an owner could be forced to pay twice for the same work, for example, if it were determined that the complaining subcontractor or supplier was not entitled to the payment sought.

Third, the case ignores the powerful remedy, albeit against a general contractor and not an owner, available to subcontractors: the Contractor and Subcontractor Payment Act, 73 P.S. §501 (CASPA). Under CASPA, a subcontractor is entitled to damages of 1 to 2 percent per month plus attorney fees if it establishes, respectively, that the general contractor wrongfully withheld payment and is determined to be a substantially prevailing party.

Finally, *Trevdan* removes a sense of finality once available to owners who had not received a notice of lien within six months after the completion of work on a project. Following *Trevdan*, an owner's sense of finality comes only with the expiration of the four-year statute of limitation for breach of contract.

SO WHAT CAN AN OWNER DO?

While it remains to be seen whether *Trevdan* will be limited to its facts or to cases where a defaulting general contractor seeks bankruptcy protection, until the reach of *Trevdan* is determined, a Pennsylvania owner or developer would be best served with the inclusion of certain limiting language within its contract with a general contractor.

Specifically, the contract should include at least the following terms:

- No subcontractors or suppliers of any tier are intended third-party beneficiaries of the contract;
- No subcontractors or suppliers of any tier have the right to assert an equitable lien claim against the owner;
- The owner has the right, but not any obligation, to make payments to subcontractors or suppliers of any tier following a payment default by the general contractor;
- The sole remedy available to subcontractors and suppliers of any tier against an owner is via a properly perfected mechanics' lien claim; and
- All agreements between the general contractor's its subcontractors and suppliers specifically include language echoing Paragraphs 1-4. •

By including this language, owners can perhaps limit their exposure for the sins of their general contractors to the extraordinary remedy established by the Legislature: a mechanics' lien. •

Identify and Manage Risks Arising From the Use of BIM

BY MICHAEL J. CREMONESE AND CHAD A. WISSINGER
Special to the Legal

Building Information Modeling (BIM) software is a powerful tool with enormous potential to streamline the construction process. According to the American Institute of Architects, a building information model "… is a digital representation of the physical and functional characteristics of the project."

Architects initially hold the power of BIM, though they must share its capabilities to enhance construction efficiency. BIM not only allows a project's design to be viewed in three or more dimensions, but also it can demonstrate the means by which a building should be constructed, locations for crane placements, manpower loading, and other means and methods issues. Utilized appropriately, BIM can reduce construction time, costs and claims.

RISKS

In order to maximize BIM's potential, every party on a project must have access to the model, and many may even modify the model. For all involved, there will be risk associated with the development, control and use of the model; potential errors and omissions; cost estimating and control; facilities management and operations; and preservation of the model.

• Development, Control and Use of the Model

Once the model is developed by the architect, subsequent modifications to the model by others present liability exposure to the creator of the model, as well as to the parties making the modifications. Additionally, because multiple parties may be modifying the model, questions will arise about the intellectual property of each of the users, and potentially of the overall model itself.

These problems are only enhanced by the ability to use and alter the model for other projects. Once created, the model will be stored, in some manner, on many users' computer networks. As such, there is far less control over information that was once committed to two-dimensional paper, both during the existing project and against subsequent use on future projects.

• Design Errors and Omissions

Many jurisdictions have held that contractors have a direct cause of action against an architect based on detrimental reliance for drawings that contain errors with regard to how a building might be constructed. These cases typically fall into the category of "negligent misrepresentation" on the part of the architect. As BIM demands closer relationships between parties without contractual privity, negligent misrepresentation claims are likely to increase with regard to design standard of care issues.

• Cost Estimating and Control

BIM allows for early collaboration by the owner, architect, contractor and others. Benefits of this early collaboration include the ability to perform early cost estimating, and earlier modification of the design to control costs. Therefore, if an owner has a defined budget, BIM should permit the construction team to determine whether the design complies with the budget. This will provide the owner with an expectation that what is designed will result in a completed project within the budget.

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While the model may provide more accuracy in cost estimating, the model cannot be relied upon to anticipate cost fluctuations or bidding strategies on public projects. The difficult economic climate currently in existence has, in some sectors and areas of the country, created a "race to the bottom" in terms of contractors' willingness to obtain work for rock bottom prices.

On the flip side, the bids for construction could still come in over budget. Recent tight supplies of petroleum products and ever-rising costs of other fossil fuels, has, for example, caused dramatic price spikes with plastic piping, steel, wiring, and other essential construction materials. Further, state-sponsored construction booms in developing nations such as China frequently result in unpredictable spikes in demand for materials such as wood and concrete.

• Facilities Management and Operations

Concurrent with the BIM's increased usage is an industry shift to energy efficient design. While the current consensus is that BIM has limited impact on sustainable design, it is anticipated that this will change after BIM is utilized to its full capacity. It soon will come to pass that energy efficiency easily will be measured and run back against the design assumptions that were made in the project at issue. This will become increasingly important as the U.S. Green Building Council continues its trends toward requiring operational proof of efficient design with utility usage data and other verifiable measures of performance to maintain LEED Certification.

Further, as states begin to enact Green Building Codes, being able to easily review designed energy efficiency against actual performance will be critical in determining liability, if the question arises. Fortunately, several recent studies suggest that energy efficient designs perform at, or above, their predicted levels of efficiency in the years immediately post-construction.

• Preservation of the Model

At this point in time, once construction documents are finalized, paper copies can be generated and copied. The loss of the master set of drawings can be replaced with other copies.

However, in designing with BIM, the final design is saved to a computer. Back-ups will have to be routinely performed to capture each change after the most recent version is saved. Likewise, copies saved to disc will have to capture all changes. What happens if the network of the party using the model crashes or there is corrupted data in the model?

Before completion, such an event can lead to a significant delay on the project due to the time necessary to recreate the model. If data preservation efforts have failed, the party using the model will likely bear the responsibility for this occurrence.

MANAGING RISK

The first key to managing BIM's risks is to become proficient in using the technology and understanding its capabilities. If those proficient in using BIM are not the individuals making design judgments, the initial architectural firm runs the risk of miscommunication, which can lead to design errors.

This miscommunication can also result in a lack of fulfillment of an owner's expectations. Any time an owner ultimately is unhappy with a finished product, the potential for claims is increased. As such, a firm needs to commit the resources for senior level persons to obtain the knowledge and training necessary to implement BIM and design in the model.

And on the construction side, if inexperienced individuals are charged with using the model, a contractor can easily create liability for faulty modifications to the model. Similarly, if the contractor's project manager does not understand the model's full potential, significant benefits may not be realized, causing delays or field coordination problems that the model could easily have avoided.

Perhaps most importantly, utilizing BIM in a collaborative effort requires clear assignment of the parties' roles, rights and risks. This can be accomplished only through well negotiated, written contracts.

For instance, the project contracts will have to include indemnifications for information entered into the model by entities not under the responsible control of the architect, including any specifically designated owner's consultants. The contracts will also need to detail whether the model can be modified by anyone other than the architect, and if so, how such modification will be tracked. If the model can be modified by others, Pennsylvania will have to reconsider its anti-indemnification statute.

Finally, all parties must discuss the use of this technology with their insurance brokers and relevant carriers. On the professional malpractice insurance side alone, the number of carriers competing for business has ballooned from less than ten to more than 45 in the past 10 years. Each policy is different, and must be examined carefully.

THE NEXT STEP FOR BIM?

Since BIM anticipates a collaborative project environment, BIM is the tool paving the way for Integrated Project Delivery (IPD). Depending on with whom you discuss IPD, many believe it promises to be the project delivery system that minimizes or even eliminates claims. Certainly, IPD can further reduce risk and claims, particularly on complex projects where even small delays can snowball if they occur along the project's critical path.

However, there currently are obstacles to true IPD, including the manner in which the project contracts should be structured. Should the traditional owner/architect and owner/contractor agreements be used? If so, how can true collaboration be achieved?

A second option is a multi-party agreement whereby all of the key members of a project team are parties to the agreement. This type of arrangement is based upon a mutual understanding that the owner will have a guaranteed maximum price for construction from which only the actual cost of the architect and contractor will be paid. If the project successfully comes in under budget, then the savings will be shared amongst the owner, architect and contractor. Each party, therefore, would have incentive to cooperate with the goal of achieving the owner's objective while saving money in order to maximize their own profits.

A third means by which to perform IPD is through the formation of a Single Purpose Entity (SPE). However, the SPE also has limitations. For instance, the owner's contribution to the SPE is the property and funds to construct the project. The architect's contribution to the SPE is the design of the project. The contractor's contribution is the skill to construct the project.

In theory, unifying these three entities into one SPE creates a relationship of trust and confidence with a common goal – a successful project. However, time and again, partnerships fail because some partners believe that others are not performing to the best of their abilities.

Additionally, the formation of an SPE will have tax and wind-down implications that must be considered, and are unique to each state in which the project is located, and/or the SPE is formed and incorporated.

CONCLUSION

It is our opinion that BIM will not only change the way buildings are designed and constructed, but also the way the construction industry operates. Unfortunately, as with many legal issues, published case law will lag years behind project experiences in terms of understanding liability with regard to the use of BIM. For that reason, all parties involved must be mindful of potentially new risks while embracing a technology that may ultimately reduce litigation related to construction projects. •

ADR

continued from **CL2**

• Naming the provider, if any;

• Specifying the rules, if any, applicable to the proceedings; and

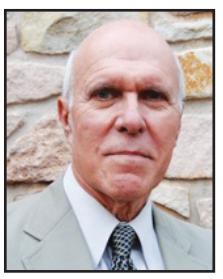
• Granting to the arbitrator(s) the authority to decide all issues, including existence and scope of the agreement to arbitrate.

The failure to cover the essential elements in a clear, concise and unambiguous way can not only lead to court, but runs the risk of inconsistent results.

For example, in a case in Pennsylvania involving construction of a high school building, the school district sued the firm of architects/engineers for alleged defects in the design of the building. The defendant joined several subcontractors in the suit, one of which objected and sought arbitration based on the clause in its contract that referred all claims, disputes and other matters relating to the agreement or a breach thereof to arbitration, but also provided that there could be no joinder with disputes involving any parties other than the parties to this contract.

The trial court awarded arbitration to the subcontractor, but on appeal the Commonwealth Court reversed and denied arbitration on the grounds that separating out the subcontractor from the other parties to the litigation would defeat the intended efficiencies of the arbitration agreement.

In a similar case, the Superior Court of Pennsylvania reached the opposite result, holding that a subcontractor was entitled to arbitrate liability for injuries to a worker on the project, even though all other contractors on the job were parties to a court lawsuit over the same issues.



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Recent litigation in the U.S. Supreme Court has emphasized both the contractual foundation for arbitration and the power of the arbitrators to decide the existence and scope of the arbitration, but insisting that the power be exercised in a manner consistent with proper contract interpretation.

Where the court found that the arbitrators had failed to utilize elements of interpretation to determine the intention of the parties, the court vacated the award and denied the arbitrability of the issues in dispute. In that case, the parties had agreed that the contract language was silent as to the particular question at issue and agreed that the arbitrators could decide whether the claims were arbitrable.

The Supreme Court found that the panel of arbitrators had not considered such matters as common practices in the industry as to whether such claims were to be included in arbitration unless specifically excluded, or whether the opposite was common practice. Instead, the court held, the arbitrators has decided arbitrability based on their view of public policy that favors arbitration of disputes. The court insisted that arbitration is a matter of contract and that all issues of arbitrability must be decided as matters of the contract between the parties to the dispute.

All of which returns us to the starting point of all arbitration contracts, which is the need to draft clear, concise, unambiguous provisions that cover all the essential elements and to make sure that all contracts that relate to the project contain both the agreement to arbitrate and language that is consistent with that of the principal contract or contracts, especially including the right to have all claims joined in the same proceeding and granting to the arbitrator the power to decide all issues, including whether and the extent to which given claims are to be subject to arbitration.

In that connection, it should be noted that the arbitration provision is considered to a "contract within a contract," so that an argument that a contract is void for some reason will not make the arbitration clause inoperative. The arbitrator will have jurisdiction to determine whether the contract is void or voidable, and a holding that voids the contract will not void the decision of the arbitrator.

Once the dispute has been referred to arbitration and the arbitrator selected, an experienced and knowledgeable arbitrator will manage the process in order to provide as prompt and efficient procedure as fits the situation. A preliminary conference should be held promptly, at which all known factors can be discussed and a schedule established for any preliminary motions, the extent and duration of discovery, designation of expert witnesses, exchange of expert reports, exchange of witness and exhibit lists, exchange of exhibits for hearing, dates for submission of hearing memorandums, for final pre-hearing conference, for submission of any pre-hearing motions and, finally, dates for hearings.

Hearings should be scheduled for consecutive days and should avoid delays between hearing days to the extent practicable. Post-hearing memorandums and argument, if requested, should be scheduled for as promptly after hearing as the size and complexity of the matters under review warrant.

Obviously the schedule will be dealt with flexibly, consistent with keeping the process moving in order to save time and money for the parties. Interim telephone conferences should be held to allow the arbitrator to stay abreast of developments, to deal with any issues that have arisen and to keep the case moving expeditiously. Issues that arise during discovery can be dealt with immediately by telephone conference.

Finally, once all submissions have been received, the arbitrator should render a decision promptly. The format for the decision may be the subject of agreement among the parties, but in general the arbitrator should articulate the basis for his or her findings. Elaborate findings of fact and conclusions of law are discouraged as being needlessly time-consuming and cost-ineffective.

The basic premise of arbitration of construction disputes is that the parties want assurances that their evidence will be heard and listened to, that the arbitrator will have the knowledge and experience to understand and evaluate the evidence, that the process will be handled in a sensible, efficient and cost-effective manner, that undue legalisms will be avoided, and that a fair and unbiased decision will be rendered promptly.

All of that can be accomplished with properly drafted arbitration provisions and the careful choice of arbitrator. •

RFP

continued from **CL3**

"PROJECT TITLE: Renovation of Foster Union. BRIEF DESCRIPTION: Work consists of renovation and additions to an approximately 50,000 SF building, including site work, hazmat abatement, demolition, general construction, HVAC, plumbing, electrical, and related work."

The court reasoned that based on this description, "there is nothing unique about the work that required DGS to use an RFP or to state in its Determination to Use the Request for RFPs that experience with 'this type of work' was needed. The above description is ordinary construction work."

Further, coordinating work and completing the project on time is expected on all construction projects. The court found that a statement that DGS would consider criteria other than costs without further information gave bidders no information about what DGS would consider in the proposals.

The court directed that "DGS must explain the nature of the contract and state with specificity why, for example, the renovation of Foster Union required closed sealed proposals and why general contract work required specialized bidding when the work was not intricate or specialized. If the use of RFPs denied contractors the right to bid, then DGS would have to provide notice and a hearing and give specific reasons why RFPs were utilized."

After noting the project at issue did not provide enough specificity to comply with the Procurement Code, the court concluded its opinion stating, "[i]n order for DGS to use RFPs in the future, it must meet a higher standard than it currently uses to prove that it is not 'practicable or advantageous' to use competitive sealed bidding under Section 511."

THE IMPACT ON BIDDING

Clearly, the Commonwealth Court was unwilling to provide DGS with carte blanche to move away from the low-bid contracts. It remains to be seen whether "ordinary construction" will meet the standard, provided DGS articulates more fully the basis for the best value procurement, or whether the construction at issue must be sufficiently specialized to meet the heightened standard set forth in *PA Associated Builders*. In those cases, the commonwealth's determination of use will be subject to judicial scrutiny when unsuccessful bidders elect to challenge the use of the RFP method under Section 1711(a) of the Procurement Code.

If the commonwealth persists with best value procurement, an uptick in bid protests is likely.

Absent review by the Pennsylvania Supreme Court, it is likely that contractors will see the commonwealth return to competitive sealed bidding and the RFP method will be reserved for projects that require specialized expertise. Many contractors will welcome the return of the more objective criteria that will allow estimators a more predictable process and the opportunity to hone their respective competitive advantage. •

Statutory

continued from **CL4**

Moreover, a contractor need not be the general contractor on a construction project to qualify as a statutory employer with respect to its own subcontractor's employees, as long as it can provide evidence to support a vertical chain of contracts, according to *McCarthy v. Dan Lepore & Sons Co. Inc*.

First, the contractor seeking immunity must be under contract with the owner of the premises or with another contractor who is in the position of the owner. Second, the contractor seeking immunity must be in sole or common control of the job premises with a general contractor. Third, the contractor seeking immunity must subcontract a part of its regular business to the subcontractor whose employee suffers an injury.

BUSINESS ENTRUSTED TO SUBCONTRACTOR

A general contractor can satisfy element four of the statutory employer test with a showing that the subcontracted work was an obligation assumed by the general contractor as part of its contract with the owner, or one in the position of the owner, according to *McCarthy v. Dan Lepore & Sons Co. Inc.*

The general contractor is not required to establish that the specific activities performed by the subcontractor were exactly the same as the activities performed by the general contractor as part of its day-to-day regular business. To the contrary, courts in Pennsylvania have recognized that general construction contractors will, as part of their regular course of business, subcontract various portions of its contractual obligations to a qualified subcontractor.

SUCONTRACTOR EMPLOYEES

Finally, in order to enjoy immunity status under the statutory employer doctrine, a general contractor must show that the injured party was an employee of the subcontractor, per *McDonald*. If, for example, the injured party was an independent contractor or a temporary worker, the statutory employer doctrine will not apply, and the general contractor can be held liable if that individual is injured.

Despite its criticisms, the statutory employer doctrine remains alive and well in Pennsylvania as an important defense for employers in the construction industry. •