



COMMONWEALTH OF PENNSYLVANIA CONSTRUCTION LAW COMPENDIUM

Prepared by

**Louis J. Vogel, Jr. and Denise M. Montgomery
Sweeney & Sheehan, P.C.**

1515 Market Street, 19th Floor
Philadelphia, PA 19102
(215) 563-9811

www.sweeneyfirm.com

Pion, Nerone, Girman, Winslow & Smith, P.C.

1500 One Gateway Center
420 Fort Duquesne Blvd.
Pittsburgh, PA 15222
(412) 281-2288

www.pionlaw.com

The following synopsis of construction law in the Commonwealth of Pennsylvania is designed as an overview of basic legal principles and for use as a research tool. It is not meant to be a comprehensive summary of relevant law, nor is it to be interpreted as providing legal advice to the reader.

I. BREACH OF CONTRACT

In Pennsylvania, as elsewhere, agreements for the construction of a home, public utilities, private commercial structures, excavation, sewers, roadways and the like are typically memorialized in a contract between the purchaser and the builder. Pennsylvania contract law encompasses general, basic rules of contract construction. Contracts in Pennsylvania are also subject to the statute of frauds.

The general rule in Pennsylvania is that the provisions of UCC Article 2 do not apply to contracts for the construction of residential homes and commercial real estate, in that they are not contracts for the sale of "goods." *DeMatteo v. White*, 336 A.2d 355 (Pa. Super. 1975). See *Gustine Uniontown Associates, Ltd. ex rel. Gustine Uniontown, Inc. v. Anthony Crane Rental, Inc.*, 892 A.2d 830 (Pa. Super. 2006). However, when a contract calls primarily for the purchase/delivery of equipment, or pre-assembled units which require little construction work on site, the Uniform Commercial Code may apply. *Cober v. Corle*, 610 A.2d 1036 (Pa. Super. 1992).

Ordinarily, the specifications of a construction contract will clearly denote the "kinds, quality, and quantity of work to be done, the details, time and manner of construction, without which the contract would be incomplete and ineffective." *Z & L Lumber Co. of Atlasburg v. Nordquist*, 502 A.2d 697, 701 (Pa. Super. 1985); see also *Knelly v. Horwath*, 57 A. 957 (Pa. 1904). A violation of one of these numerous provisions could give rise to a breach of contract action against the builder because when performance under a contract is due, any nonperformance is a breach. *Widemer Eng'g, Inc. v. Dufalla*, 837 A.2d 459, 468 (Pa. Super. 2003); See also Restatement (Second) of Contracts §235(2) (1981). If a breach constitutes a *material* failure of performance, then the non-breaching party is discharged from all liability under the contract. *Id.* In considering whether a failure of performance is material, the following factors are considered:

- a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- b) the extent to which the injured party can be adequately compensated for that part of that benefit of which he will be deprived;
- c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;

- d) the likelihood that the party failing to perform or offer to perform will cure his failure, taking into account all the circumstances including any reasonable assurances;
- e) the extent to which the behavior of the party failing to perform or offer to perform comports with standards of good faith and fair dealing.

Id. at 469; Restatement (Second) of Contracts §241 (1981). See also *Int'l Diamond Importers, Ltd. v. Singularity Clark, L.P.*, 2012 PA Super 71 (Pa. Super. Ct. Mar. 22, 2012);

An *anticipatory* breach occurs whenever there has been a definite and unconditional repudiation of a contract by one party communicated to another. A statement by a party that he will not or cannot perform in accordance with agreement creates such a breach. *Oak Ridge Construction Co. v. Tolley*, 504 A.2d 1343 (Pa. Super. 1985); see also Corbin on Contracts § 959 (1993); Restatement (Second) of Contracts § 250 (1981); *Integrated Waste Solutions, Inc. v. Goverdhanam*, CIV.A. 10-2155, 2012 WL 2885947 (E.D. Pa. July 13, 2012).

When a party to a contract seeks to enforce the agreement or to recover damages for breach of the agreement, that party must prove that he has performed all of his own obligations under the contract. See *Trumbull Corp. v. Boss Construction, Inc.*, 801 A.2d 1289 (Pa. Commw. 2002). See also *Evergreen Cmty. Power LLC v. Riggs Distler & Co., Inc.*, 513 F. App'x 236, 240 (3d Cir. 2013) Breach of contract actions are also often accompanied by other causes of action.

II. NEGLIGENCE

Typically, defective construction cases include negligence claims. Such cases include allegations that, inter alia, the builder breached the duties of reasonable care, reasonable workmanship and/or violated any of the various obligations imposed by law. See Section III, *infra*. However, tort claims may be barred by the economic loss doctrine or the gist of the action doctrine. See Sections VIII and IX, *infra*.

The waiver of subrogation clause contained in a standard American Institute of Architects (AIA) agreement precludes negligence and breach of contracts claims. *Universal Underwriters Ins. Co. v. A. Richard Kacin, Inc.*, 916 A.2d 686 (Pa. Super. 2007). After the insurer paid its insured car dealership for damage resulting from the collapse of a wall, the insured brought a subrogation action against the general contractor and subcontractor, alleging negligent construction. The insurer argued that the waiver of subrogation clause could not be enforced against it because it was not a party to the agreement and did not receive notice or give its consent. In ruling on this issue of first impression, the Superior Court rejected the insurer's contention that notice or consent was required to enforce the provision, stating that in Pennsylvania, a subrogee essentially "stands in the shoes" of its subrogor. *Id.* at 693. Subrogation is derivative in nature,

placing the subrogee “in the precise position of the one to whose rights and disabilities he is subrogated.” *Church Mut. Ins. Co. v. Palmer Const. Co., Inc.*, 153 F. App'x 805, 808 (3d Cir. 2005) quoting *Allstate Ins. Co. v. Clarke*, 364 Pa.Super. 196, 527 A.2d 1021, 1024 (1987).

Decisional law from the U.S. District Court, Western District of Pennsylvania has suggested that a Plaintiff asserting a negligence claim need not be in privity with a contractor or construction professional to maintain a negligence action under Pennsylvania law. To establish a cause of action in common law negligence under Pennsylvania law, a plaintiff must demonstrate that the defendant owed the plaintiff a duty, that the duty was breached, that the breach caused the plaintiff's injury, and that the plaintiff suffered damages. *Harris v. Merchant*, 2010 U.S. Dist. LEXIS 100776, 2010 WL 3734107, at *21 (E.D.Pa. Sept. 23, 2010) (citing *Merlini ex rel. Merlini v. Gallitzin Water Auth.*, 602 Pa. 346, 980 A.2d 502, 506 (2009)); also see *McCandless v. Edwards*, 908 A.2d 900, 903 (Pa.Super.2006).

However, a contractor's duty of care extends to a downstream purchaser based on public policy concerns. In *AMCO Insurance Co. v. Emery and Associates*, the Court was confronted with claims filed by an insurer, as subrogee for the new owner, against the former owner and the general contractor to recover monies paid as a result of a fire at a hotel in East Franklin Township, Pennsylvania. 926 F. Supp. 2d 634 (W.D. Pa. 2013). The insurer filed claims alleging negligence per se, negligence, breach of contract, and breach of warranty. Ultimately, the *AMCO* Court determined that the general contractor owed a duty of care, despite the lack of a direct relationship with the new owner, as negligent building practices would affect subsequent purchasers.

Previously, the Pennsylvania Superior Court has articulated the following factors in determining the existence of a duty: (1) the relationship between the parties; (2) the social utility of the actor's conduct; (3) the nature of the risk imposed and foreseeability of the harm incurred; (4) the consequences of imposing a duty upon the actor; and (5) the overall public interest in the proposed solution. *F.D.P. ex rel. S.M.P. v. Ferrara*, 804 A.2d 1221, 1231 (Pa.Super.2002). Weighing these factors, the District Court held that,

“In applying these factors the Court finds that the factors weigh, though somewhat tenuously, in favor of finding a duty of care in constructing the hotel owed by Emery to AMCO's insured. Though there is no direct relationship between the parties, a contractor is certainly aware that a commercial building is likely to have multiple owners and negligent building practices will affect subsequent purchasers. Clearly, Emery's services provide ample social utility, however it is foreseeable that negligent construction with regard to fire code requirements could result dangerous consequences. Moreover, the public interest lies in imposing a duty on those who are negligent in following required building codes.” *Id.*

In light of the District Court's decision in *AMCO*, privity of contract is no longer dispositive in determining a negligent construction claim. As such, this decision has increased the pool of potential Plaintiffs to negligence actions against Pennsylvania builders, developers, and contractors.

Additionally, recent decisional law has eliminated the Certificate of Merit requirement as to design professionals for claims asserted by third parties. In Pennsylvania, a Plaintiff alleging negligence against a license professional, such as an architect or engineer, is required to provide a Certificate of Merit within sixty (60) days of instituting a Complaint stating that:

- (1) an appropriate licensed professional has supplied a written statement that there exists a reasonable probability that the care, skill or knowledge exercised or exhibited in the treatment, practice or work that is the subject of the complaint, fell outside acceptable professional standards and that such conduct was a cause in bringing about the harm, or
- (2) the claim that the defendant deviated from an acceptable professional standard is based solely on allegations that other licensed professionals for whom this defendant is responsible deviated from an acceptable professional standard, or
- (3) expert testimony of an appropriate licensed professional is unnecessary for prosecution of the claim. Pa.R.C.P. 1042.3 (2015).

However, this requirement is not applicable to third-parties. In *Bruno v. Erie Ins. Co.*, a Plaintiff was permitted to file suit against an engineer, even in the absence of a contract, under the Bilt-Rite exception to the economic loss doctrine. See Section IV *infra*. Relying on the express terms of Rule 1042 which concerns "a civil action in which a professional liability claim is asserted by or on behalf of a patient or client of the licensed professional," the Supreme Court limited application of the rule only to "clients" of the licensed professional. Accordingly, there is no Certificate of Merit obligation for a "non-client." Thus, plaintiffs asserting professional negligence claims against licensed professionals, including those involved with design, development, and construction in Pennsylvania, are not required to provide such a Certificate within sixty days of instituting a Complaint.

Recently, the Pennsylvania Superior Court clarified the legal requirements for a contractor's direct claim for economic losses against a design professional caused by defective design. As noted above, defective design claims in Pennsylvania often include negligence claims. In *Gongloff Contracting v L. Robert Kimball & Associates*, the Court held that to bring a *design defect* claim against a design professional, it is sufficient to merely allege that a design

professional had negligently included faulty information in the design documents, as long as the claimant was intended to rely on such information. Under the *Gongloff* holding, a contractor's claim for economic losses against a design professional under *Bilt-Rite*¹ may be asserted simply based on an allegation that a defective design included faulty information in the design documents in that the **defective design itself** can be construed as a misrepresentation by the design professional that the plans and specifications, if followed, would result in a successful project.

III. BREACH OF EXPRESS AND IMPLIED WARRANTY CLAIMS

Construction defect cases often include breach of warranty claims. Such claims are based on express warranty provisions contained within the contract between the plaintiff and the builder/developer, and/or those warranties implied by law.

There are various obligations implied by law upon construction contracts. Under the implied warranty of workmanship, a person working on a construction project under a construction contract or subcontract impliedly warrants that: 1) he will do his work in a good and workmanlike manner according to existing standards of construction in the area in which the building is erected and 2) the materials used are sound. See *Pontiere v. James Dinert, Inc.*, 627 A.2d 1204 (Pa. Super. 1993).

A warranty of habitability is also implied in a construction contract. *Elderkin v. Gaster*, 447 Pa. 118, 288 A.2d 771 (1972). Pennsylvania courts have ruled that a breach of the implied warranty of habitability has occurred in a variety of situations, including where no potable water is supplied, *Id.*; furnaces are constructed in a defective manner so as to lead to increased carbon monoxide emissions, *Pontiere, supra*; lead based paint was used to paint the interior of the home, *Lititz Mut. Ins. Co. v. Steely*, 785 A.2d 975 (Pa. 2001); leaking skylights, *Fetzer v. Vishneski*, 582 A.2d 23 (Pa. Super. 1990), *appeal denied*, 593 A.2d 842 (Pa. 1991); a basement continually leaks, *Ecksel v. Orleans Const. Co.*, 519 A.2d 1021 (Pa. Super. 1987); and where a crawl space leaks, *Tyus v. Resta*, 476 A.2d 427 (Pa. Super. 1984).

It should be noted that Pennsylvania courts have not reached a consensus on whether a vendor of a new home who was not involved in its construction can be held liable under the *Elderkin* holding. Compare *Brown v. Bankroft*, 13 D. & C.4th 313 (York Co. 1992) (holding in favor of liability in a matter involving a new home) with *Boozell v. Bollinger*, 30 D. & C.3d 247 (Mercer Co. 1983) (holding against liability; used home involved). However, regardless of privity of contract, the builder of a residential unit who is not the seller is held to have extended the implied warranties of workmanship and habitability to the purchaser. *Spivack v. Berks Ridge Corp., Inc.*, 586 A.2d 402 (Pa. Super. 1990). However, the implied warranty of habitability is not extended to a subsequent purchaser of residential real estate under Pennsylvania law. *Conway v. Cutler*, No. 80 MAP 2013 (Pa. Aug 18, 2014). Rather, the implied warranty of habitability is limited to the

¹ *Bilt-Rite Contractors v. Architectural Studio*, 866 A.2d 270 (Pa. 2005)

original homeowners who have contractual privity with the vendor and/or builder of said property. *Id.*

The implied warranties of workmanship and habitability may be limited and/or disclaimed provided that various requirements are met, including specificity of the rights being waived and the defects excluded. *See Pontiere v. James Dinert, Inc.*, 627 A.2d 1204, 1207 (Pa. Super. 1993), *alloc. denied* 641 A.2d 588; *Tyus v. Resta*, 476 A.2d 427 (Pa. Super. 1984).

Implied warranties are also imposed upon building or site owners. It is a well-established doctrine that an owner who issues detailed plans and specifications impliedly warrants that the project is capable of being constructed in accordance with those plans and specifications. *Stabler Constr. v. DOT*, 692 A.2d 1150 (Pa. Commw. 1997). Thus, a contractor who performs in strict compliance with provided detailed plans and specifications is not responsible for defects in the result. *Id.* at 1152, *citing Dept. of Transp. v. W. P. Dickerson & Son, Inc.*, 400 A.2d 930, 932 (Pa. Commw. 1979).

IV. CONSTRUCTIVE FRAUD

A contractor may recover expenses incurred as a result of unforeseen construction site conditions when bringing an action based on constructive fraud. The common law recovery theory of constructive fraud is based on the premise of a misleading statement regarding site conditions contained in the contract documents prepared by the owner. *See Acchione & Canuso, Inc. v. Comm. of Pa., Dept. of Transp.*, 461 A.2d 765 (Pa. 1983); *see also I.A. Constr. Co. v. Comm. of Pa., Dept. of Transp.*, 591 A.2d 1146 (Pa. Commw. 1997). Constructive fraud cannot arise unless the owner of the site made positive representations regarding the site conditions. *Black Top Paving Co., v. Comm. of Pa., Dept. of Transp.*, 466 A.2d 774 (Pa. Commw. 1983) (no constructive fraud if the contractor's own pre-bid site investigation revealed the inaccuracy in the owner's contract documents).

The Pennsylvania Supreme Court listed five (5) factors in the *Acchione* decision that a contractor must prove in order to recover on a common law theory of constructive fraud. These five factors are: 1) whether the owner or its agent (an architect or engineer) made a positive representation of specifications or conditions regarding the contract work; 2) whether the representation relates to material specification in the contract; 3) whether the contractor, due to time or cost constraints, is unable to make an independent investigation of the site conditions or the owner's representations; 4) whether the owner's representations are false and/or misleading due either to actual misrepresentation or a misrepresentation caused by gross mistake or arbitrary action; and 5) whether the contractor suffered financial harm due to reliance on the misrepresentation. *Acchione*, 461 A.2d at 768. *See Dept. of General Services v. Pittsburgh Bldg. Co.*, 920 A.2d 973, 985 (Pa. Commw. 2007).

Design professionals, such as architects, may be held liable where the contractor submitting the winning bid reasonably and relies upon misrepresentations in the architect's plans for a public construction contract, despite the lack of a contractual relationship between the architect and contractor, when such reliance is foreseeable. *Bilt-Rite Contractors v. Architectural Studio*, 866 A.2d 270 (Pa. 2005) (adopting Restatement (Second) of Torts §552).

The applicability of *Bilt-Rite* is dependent on the relationship between plaintiff and defendant. In *Excavation Technologies, Inc. v. Columbia Gas Company of Pennsylvania*, 2009 W.L. 5103605, 985 A.2d 840, (Pa.2009), the court limited the scope of the *Bilt-Rite* exception to the economic loss doctrine. The *Excavation Technologies* court stated that Restatement (Second) of Torts §552 is inapplicable when the contractor's "complaint fails to state a claim within the parameters of Section 552(1) and (2) because the utility is not a defendant who is akin to the architect in *Bilt-Rite* who was a professional information provider." *Id.* at 843. To pursue a claim for purely economic loss, the target defendant must be in the business of providing information for pecuniary gain. *Id.* See also *Fed. Ins. Co. v. Handwerk Site Contractors*, 1:10-CV-617, 2012 WL 5949213 (M.D. Pa. Nov. 28, 2012)

V. STRICT LIABILITY

Strict liability claims against builders in Pennsylvania construction cases do not usually pass muster as 402A of the Restatement (Second) of Torts, applies to "products," *Burrows v. Jones*, 17 Pa. D. & C.4th 224 (Pa.Com.Pl. 1992), and the construction of homes and the like are not considered "products" for strict liability purposes. *Id.* In *Burrows*, the plaintiffs lived in a pre-fabricated modular residence that had a pre-existing spot for a fireplace. After purchasing the home, the plaintiffs had a fireplace installed by a different individual from the designer and the home constructor. Thereafter, pyrolysis occurred within the fireplace causing an eruption and burning down the home. The plaintiffs sued the fireplace installer, the designer and the constructor of the home in causes of action based in strict liability and negligence. Ultimately, the strict liability claim was dismissed under the authority of *Cox v. Shaffer*, 302 A.2d 456 (Pa. Super.1973), *alloc. denied* 368 A.2d 897, wherein the Pennsylvania Superior Court stated that a silo constructed in place on land was not a "product." *But see Bednarski v. Hideout Homes & Realty, Inc.*, 711 F. Supp. 823 (M.D. Pa. 1989) (federal court predicts that Pennsylvania Supreme Court will find that builders may be held strictly liable for alleged defect in a house).

However, one should see *Ettinger v. Triangle-Pacific Corp.*, 799 A.2d 95 (Pa. Super. 2002), *appeal denied* 815 A.2d 1042 (Pa. 2003) (criticizing *Cox* for providing no explanation underlying its holding, further criticizing *Lupinski v. Heritage Homes, Ltd.*, 535 A.2d 656 (Pa. Super. 1988) for footnote citing *Cox* as existing case law in Pennsylvania suggesting buildings are not products for § 402A purposes). Ultimately, these cases have not been overturned, but merely criticized, and as the Supreme Court of Pennsylvania has not spoken on the issue, it would seem that at present buildings are not "products."

It should be noted that on November 19, 2014, the Supreme Court of Pennsylvania decided the matter of *Tincher v. Omega Flex*, which is likely to overhaul strict liability law in the Commonwealth of Pennsylvania. However, the Court's broad opinion was silent with regard to the effect, if any, of its decision on existing Pennsylvania construction law. As stated above, the construction of homes is not deemed a "product" for strict liability purposes. *Tincher* does not appear to change this position. However, Courts have had few opportunities to apply the *Tincher* holding to construction matters. As such, this is an area of law that may be susceptible to change in the near future.

VI. INDEMNITY

A. The Basics of Indemnity

The easiest way to think about indemnity provisions is as a contractual way to allocate risk among two or more parties. It is important to understand that an indemnity provision does not eliminate liability for the indemnitee, but rather requires the indemnitor, under certain conditions, to assume that liability on behalf of the indemnitee. "Though an indemnification clause does not eliminate a party's legal obligations stemming from a bodily injury or property damage loss, it does, if enforceable, make the indemnitor (the person holding the other harmless in a contract) responsible for meeting the financial obligations of the indemnitee (the person held harmless)." Tracy Alan Saxe and Ashley Rose Adams, *Walking the Minefield: Navigating Anti-Indemnity Statutes and Maximizing Third-Party Contractual Indemnification for Construction Contracts*, 24 *John Liner Review* 35, 25 (Winter 2011).

There are three basic types of indemnity clauses, each of which differently allocates risk. Although there are no consistent nomenclature for the three types of indemnity, we will describe them as such:

1. Broad indemnity;
2. Intermediate indemnity; and
3. Limited indemnity.

It is critical to understand the distinctions among the different types of indemnity – both to ensure that, during the negotiation process you or your client fully understands the bargain and also to ensure that the indemnity clause is valid in your jurisdiction.

Under a broad indemnity clause, the "indemnitor assumes the entire risk of loss, regardless of whether or not the loss is due to the sole negligence of the indemnitee." *Id.* at 37. Note that with this type of indemnity clause, the indemnitor assumes the risk *even if the damage was caused by the indemnitee*. For reasons we will explore soon, many states view broad

indemnity clauses as either *void ab initio* or limited to circumstances where it is “clearly stated” that the parties intended such a relationship.

Intermediate indemnity clauses seek to address circumstances of concurrent liability – meaning situations in which more than one party is liable for the damage. There are two types of intermediate indemnity clauses:

- “Full indemnification is when the indemnitor will indemnify the indemnitee for the indemnitee’s negligence for the indemnitee’s negligence if the injury was not caused solely by the indemnitee.” *Id.* In other words, this type of intermediate indemnity clause will cover the full liability so long as the indemnitor is at least partially responsible for the damage.
- “Partial indemnification is when the indemnitor promises to indemnify only the percentage of negligence caused by the indemnitor itself.” *Id.* Think of this in the same way you think of comparative negligence: the indemnitor will only be liable for the proportion of damages caused by its own negligence.

In general, intermediate indemnity clauses seek to ensure that an indemnitor does not take on an all-or-nothing duty to indemnify.

Limited indemnity provisions, which are increasingly popular, limit an indemnitor’s risk to its own negligence. These clauses mean that “the indemnitee can only receive indemnification if the indemnitor was 100% negligent.” *Id.* at 36. Unlike the intermediate indemnity clauses, which provides the indemnitee protection in situations of concurrent liability, the limited indemnity clauses kick in only in circumstances where the indemnitor was the sole cause of damage.

B. The Enforceability of Indemnity Clauses

Perhaps the most important consideration when negotiating an indemnity clause is whether the clause will ultimately be enforceable. This discussion will focus on negotiating indemnity clauses valid in Pennsylvania, although we will discuss some issues that apply more broadly.

1. Broad Indemnity

Several states have declared broad indemnity clauses outright illegal (the most prominent being California). Pennsylvania, however, is among the majority of states that will enforce a

broad indemnity clause so long as the clause is clear and unambiguous. It has long been the law of Pennsylvania that the enforceability of indemnity clauses is a question of law. *Hutchinson v. Sunbeam Coal Corp.*, 519 A.2d 385, 390 (Pa. 1986). This means that whether or not the indemnity provision is clear and unambiguous will be determined by the court primarily by looking to the language used in the clause. *Fallon Elec. Col, Inc. v. The Cincinnati Ins. Co.*, 121 F.3d 125, 127 (3d Cir. 1997). Dating back to 1907, the Pennsylvania Supreme Court has held that an indemnitor can only be held liable for the negligence of the indemnitee only in circumstances where the contract is “unequivocal” on that issue. *Perry v. Payne*, 66 A. 553 (Pa. 1907). The reason for such close scrutiny is not difficult to understand: “The liability on such indemnity is so hazardous, and the character of the indemnity so unusual and extraordinary, that there can be no presumption that the indemnitor intended to assume [such expansive indemnity obligations] unless the contract puts it beyond doubt.” *Id.* at 557.

This general rule was revisited by the Pennsylvania Supreme Court in *Ruzzi v. Butler Petroleum Co.*, 588 A.2d 1 (Pa. 1991). *Ruzzi* provides significant guidance with regard to what “clear and unambiguous” means. In *Ruzzi*, a property owner contracted to indemnify a contractor “from any and all liability for claims for loss, damage, injury or other casualty to persons or property caused” by the contractor’s work. Notably, the Supreme Court held that this language was not sufficiently specific to require the property owner to indemnify the contractor. “We conclude that the only intent that can be gleaned from this document is that the parties did not intend to indemnify for acts of the indemnitee’s negligence, since words of general import are used. We can discern no reason to abandon the *Perry* rule of contract interpretation which is still a valuable rule of construction, rooted in reason and authority.” *Id.* at 5.

The Pennsylvania General Assembly has codified this rule in 68 Pa.C.S. § 491:

Every covenant, agreement or understanding in or in connection with any contract or agreement made and entered into by owners, contractors, subcontractors or suppliers whereby an architect, engineer, surveyor or his agents, servants or employees shall be indemnified or held harmless for damages, claims, losses or expenses including attorneys' fees arising out of: (1) the preparation or approval by an architect, engineer, surveyor or his agents, servants, employees or invitees of maps, drawings, opinions, reports, surveys, change orders, designs or specifications, or (2) the giving of or the failure to give directions or instructions by the architect, engineer, surveyor or his agents, servants or employees provided such giving or failure to give is the primary cause of the damage, claim, loss, or expense, shall be void as against public policy and wholly unenforceable.

The result is that, in Pennsylvania, words of general import, such as “any and all liability,” do not rise to the level of specificity required for broad indemnification regarding a party’s own negligence. See *DiPietro v. City of Philadelphia*, 496 A.2d 407 (Pa.Super. 1985)(en banc); see also *Hershey Foods Corp. v. General Electric Service Co.*, 619 A.2d 285 (Pa.Super. 1992), *appeal denied*, 536 Pa. 643, 639 A.2d 29 (1993)(finding that a provision which states, “Whether or not” the negligent act was “caused in part by a party indemnified hereunder” to be sufficiently specific to permit indemnification even if the beneficiary of the clause was partly responsible for the harm). See also, Maggie Kucera, *Defining the Boundaries of Enforceable Indemnity Provisions Under Pennsylvania Law*, *Defense Digest*, Vol. 20, No. 1, March 2014.

2. Intermediate & Limited Indemnity

In Pennsylvania, as well, as most every state, the various forms of intermediate and limited indemnity are valid and enforceable. The one exception to this general rule aligns with the discussion above: some states have enacted legislation precluding an indemnitee from contractually assigning its own sole negligence to an indemnitor. In these states – of which Pennsylvania is not one – a “full indemnification” version of concurrent indemnity would be either *void ab initio* or subject to the same *Perry-Ruzzi* test described above.

C. THE INTERPLAY OF INDEMNITY AND INSURANCE

Too often, indemnity provisions are thought of as either part-and-parcel with a contractual obligation to name another party as an additional insured on a commercial general liability (CGL) insurance policy or as something entirely disassociated from insurance concerns. The truth is there is a complicated and important interplay between the contractual requirements to name another party (typically what would be the indemnitee) as an additional insured on a CGL policy of the indemnitor. Given that the best way to understand indemnity and insurance concerns is as the allocation of risk, it is critical to understand the basics of this relationship before negotiating any construction contract.

1. Additional Insured Status

One of the most common requirements in contracts between contractors is naming the contractor one-step up in the contracting hierarchy as an additional insured on the subcontractor’s CGL policy. What this requirement accomplishes is treating the additional insured as if it were a party to the subcontractor’s CGL policy. In other words, being named an additional insured provides the additional insured, in most instances, the same rights to

insurance coverage as the primary insured. Unlike indemnity, the allocation of risk in this circumstance is not assumed by the primary insured/indemnitor but is assigned to the insurer.

2. The Fissure Between Additional Insured CGL Coverage and Indemnity

There are three states – Kansas, Ohio, and Oregon – where there is a difficult relationship between anti-indemnity legislation and CGL coverage for an additional insured. To put it as simply as possible, these three states’ anti-indemnity legislation covers not only construction contracts (and thus indemnity provisions) but also agreements to purchase insurance. This legislation, which precludes broad indemnity provisions, extends that prohibition to CGL policies that extend to additional insureds. The Oregon Supreme Court has held a provision requiring a subcontractor to provide additional insured coverage for a general contractor for the general contractor’s sole negligence void:

Whether the shifting allocation of risk is accomplished directly, e.g., by requiring the subcontractor itself to indemnify the contractor for damages caused by the contractor’s own negligence, or indirectly, e.g., by requiring the subcontractor to purchase additional insurance covering the contractor for the contractor’s own negligence the ultimate – and statutorily forbidden – end is the same.

Walsh Construction Co. v. Mut. Of Enumclaw, 76 P.3d 164 (Ore. Ct. App. 2004).

3. Ohio’s Anti-Indemnity Statute

Perhaps the most relevant jurisdiction to discuss for our purposes is Ohio. Ohio is one state that has legislation declaring any broad indemnity agreements void. R.C. 2305.31. “Ohio’s anti-indemnity statute [...] applies to [additional insured] endorsements and operates to void any construction-related agreement that would, in effect, require another entity to indemnify a party for its own negligence.” Saxe and Adams, *supra*, at 39. There is currently a division in Ohio appellate case law: some Ohio appellate courts have found that R.C. 2305.31 also applies to additional insured CGL policies, while others have disagreed. See *Brzeczek v. Standard Oil Co.*, 447 N.E.2d 760 (6th Dist. 1982); *Stickovich v. Clevelandk* 757 N.E.2d 50 (8th Dist. 2001); *Danis Bldg. Constr. Co. v. Employers Fire Ins. Co.*, 2002 Ohio APP. Lexis 6243 (2nd Dist. 2002). “The Ohio Supreme Court has not addressed the issue. However, the appellate courts uniformly recognize that there must be a final finding of liability, through settlement or judgment, before the [additional insured] endorsement is declared void.” Saxe and Adams, *supra*, p. 39.

The take-away here is that Pennsylvania contractors must be vigilant when dealing with an Ohio-based company or for an Ohio-based project. Ohio's law regarding broad indemnity clauses and the attendant CGL additional insured requirements are – while still somewhat unsettled – fundamentally different from Pennsylvania's laws on the subject.

4. Anti-Indemnity Statutes and Negotiating Contracts

Many contractors unthinkingly include both an additional insured clause and an indemnity clause in a contract. It is imperative to understand the purpose and overlap of these two clauses. Further, as discussed specifically with respect to Ohio law, it is critical to attend to these issues while negotiating construction contracts. There are two basic considerations that should always be taken into account:

1. Identify the operative state law that applies to the contract. This can be attended to specifically by inserting a choice of law provision into the contract.
2. Be sure that, if any additional insured endorsements are required by the contract, the CGL policy actually covers the entire relevant timeframe for potential liability.

D. STANDARD FORM CONSTRUCTION CONTRACTS

Be aware that many standard construction contracts – typically the AIA form contracts and ConsensusDOCS form contracts – pose certain issues that require attention. Both the AIA and ConsensusDOCS have standard indemnification clauses that are broadly enforceable. “Both contracts are examples of partial indemnification agreements whereby the subcontractor agrees to indemnify for bodily injury or property damage only to the extent the damage is caused by the negligent acts of the subcontractor or its employees.” Saxe and Adams, *supra*, p. 43.

When negotiating contracts outside the scope of the standard form construction contracts, strongly consider using the following magic language: “to the fullest extent permitted by law.” Most states have interpreted this language to ensure that an indemnity clause will survive to the extent any individual state's law will permit. It operates in the same way as a typical severability clause.

In Pennsylvania, it is established law that a general contractor is not liable for injuries resulting from work entrusted to a subcontractor. *Leonard v. Pennsylvania Dept. of Transp.*, 771 A.2d 1238, 1240 (Pa. 2001). *Compare Farabaugh v. Penna. Turnpike Comm.*, 911 A.2d 1264 (Pa. 2006).

Pennsylvania courts use general rules of contract construction in construing express indemnity provisions. *Brotherton Construction Co. v. Patterson-Emerson-Cornstock, Inc.*, 178 A.2d

696 (Pa. 1962). However, when interpreting a broadly written indemnity provision, courts will not enforce an indemnity agreement that is drafted so broadly that would literally allow the indemnitee to recover for any and all events, unless significant extrinsic evidence indicates an intent to be bound by the provision. *Deskiewicz v. Zenith Radio Corp.*, 561 A.2d 33, 35 (Pa. Super. 1989).

A contract that entitles a party to indemnification for its own negligence is permissible, but such a contract term must be unmistakable. *Ratti v. Wheeling Pittsburgh Steel Corp.*, 758 A.2d 695, 702 (Pa. Super. 2000). Indemnity clauses are construed most strictly against the party who drafts them, especially when that party is the indemnitee. *Ratti*, 758 A.2d at 702. Pass through agreements in a subcontract indemnifying one party for the negligence of another are only enforceable where stated in clear and unequivocal terms. *Bernotas v. Super Fresh Food Markets, Inc.*, 863 A.2d 478 (Pa. 2004).

"Common law" indemnity is derived from a special relationship between the parties. *Sirianni v. Nugent Bros., Inc.*, 506 A.2d 868, 870-871 (Pa. 1986). This special relationship dictates that indemnity will be available to a person, who, without active fault, has been legally compelled to pay damages actually caused by another's negligence. *Walton v. Avco Corp.*, 610 A.2d 454, 460 (Pa. 1992). Examples of such relationships abound: an employer may secure indemnification from a negligent employee; a retailer has a right of indemnity against a negligent wholesaler or manufacturer; a property owner could recover from a contractor who failed to perform specified duties and thereby caused an injury to another; or a municipality with a duty to ensure that property owners maintain sidewalks may be indemnified by a property owner who failed to maintain a sidewalk that caused an injury to a passerby. *Builders Supply Co. v. McCabe*, 77 A.2d 368 (Pa. 1951).

"Common law" indemnity is not, however, a fault sharing mechanism between one who was predominantly responsible for an accident and one whose negligence was relatively minor. *Sirianni*, 506 A.2d at 871. Thus, parties cannot use indemnity as a tool to "equitably distribute or apportion responsibility" for an individual's injuries. *Kemper Nat'l P.&C. Cos. v. Smith*, 615 A.2d 372, 374 (Pa. Super. 1992). There can be no indemnity between parties who each bear responsibility for the wrong, albeit of varying degrees. See *City of Wilkes-Barre v. Kaminski Bros., Inc.*, 804 A.2d 89 (Pa. Commw. 2002), alloc. denied 828 A.2d 351.

Lastly, Pennsylvania recognizes third party beneficiary indemnity. "[A] party becomes a third party beneficiary only where both parties to the contract express an intention to benefit the third party in the contract itself ... unless the circumstances are so compelling that recognition of the beneficiary's right is appropriate to effectuate the intention of the parties, and the performance satisfies an obligation of the promisee to pay money to the beneficiary or the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance." *Scarpitti v. Weborg*, 609 A.2d 147, 149 (Pa. 1992) citing Restatement (Second) of Contracts §302 (1981). "The first part of this test sets forth a standing requirement which leaves discretion with the court to determine whether recognition of third party

beneficiary status would be appropriate. The second part defines the two types of claimants who may be intended as third party beneficiaries. If a party satisfies both parts, a claim may be asserted under the contract." *Id.*, citing *Guy v. Liederach*, 459 A.2d 744 (Pa. 1983). See also *Fizz v. Kurtz, Dowd & Nuss, Inc.*, 519 A.2d 1037, 1039 (Pa. Super. 1987) (it is up to the court to determine "whether recognition of a beneficiary's right to performance is appropriate to effectuate the intention of the parties."). See also *In Re Marcus Lee Associates, L.P.*, 422 B.R. 21, (Bkrtcy. Ed. Pa. 2009); *Victoria Gardens Condo. Ass'n v. Kennett Twp. of Chester County*, 1652 C.D. 2009, 2011 WL 1499666 (Pa. Commw. Ct. Jan. 21, 2011) *appeal denied*, 132 MAL 2011, 2011 WL 2640790 (Pa. July 7, 2011); *Ribarchak v. Mun. Auth. of City of Monongahela*, 44 A.3d 706, 709 (Pa. Commw. Ct. 2012) *appeal denied*, 57 A.3d 73 (Pa. 2012)

VII. STATUTE OF LIMITATIONS/STATUTE OF REPOSE

A. Statute of Limitations

The statute of limitations on claims for damages for injury to person or property that are founded on negligent, intentional, or otherwise tortious conduct, or any other action or proceeding sounding in trespass, including deceit or fraud, is two years. 42 Pa.C.S. §5524. The statute of limitations in actions upon contracts is four years. 42 Pa.C.S. §5525. This includes contract actions alleging latent real estate construction defects. *Gustine Uniontown Associates, Ltd. ex rel. Gustine Uniontown, Inc. v. Anthony Crane Rental, Inc.*, 842 A.2d 334 (Pa. 2004), on remand, 892 A.2d 830 (Pa. Super. 2006).

B. Statute of Repose

The Pennsylvania Statute of Repose is codified at 42 Pa.C.S. §5536, and provides that "a civil action or proceeding brought against any person lawfully performing or furnishing the design, planning, supervision, or observation of construction, or construction of any improvement to real property must be commenced within twelve (12) years after completion of construction of such improvements." This includes actions to recover damages for "(1) any deficiency in the design, planning, supervision or observation of construction of the improvement; (2) injury to property, real or personal, arising out of any such deficiency; (3) injury to the person or for wrongful death arising out of such deficiency; and, (4) contribution or indemnity for damages sustained on account of any injury mentioned in paragraph (2) or (3)." It should be noted that the Statute of Repose does not bar a suit against manufacturers of defective building products. The "discovery rule" applies to such cases.

The Pennsylvania Supreme Court has held that for a party to establish the immunity provided by the Statute of Repose, that party must establish that:

- (1) what is supplied is an improvement to real estate;
- (2) more than twelve years have elapsed between the completion

of the improvements to the real estate and the injury; and
(3) the activity of the moving party must be within the class which is
protected by the Statute.

McConnaughey v. Building Components, Inc., 637 A.2d 1331 (Pa. 1994). See also *Noll by Noll v. Harrisburg Area Y.M.C.A.*, 643 A.2d 81 (Pa. 1994); *Vargo v. Koppers Co., Inc.*, 715 A.2d 423 (Pa. 1998). There is little issue in any given case regarding element two of this tripartite test, since "the twelve year period begins to run when the entire construction project is so completed that it can be used by the general public." *Noll*, 643 A.2d at 84.

The Pennsylvania Supreme Court has defined an improvement to real property as [a] valuable addition made to property (usually real estate) or an amelioration in its condition, amounting to more than mere repairs or replacement, costing labor or capital, and intended to enhance its value, beauty or utility or to adapt it for new or further purposes[.]

McCormick v. Columbus Conveyor Co., 564 A.2d 907, 909 (Pa. 1989). Further, the *McCormick* court indicated that whether a particular party is within the class of persons protected by the Statute of Repose depends on whether that party "performed or furnished the design, planning, supervision of construction, or construction of an improvement." *Id.* at 910.

VIII. ECONOMIC LOSS DOCTRINE

The economic loss doctrine precludes recovery of economic losses in tort actions absent physical injury or property damage. *David Pflumm Paving & Excavating Inc. v. Foundation Services Co.*, 816 A.2d 1164 (Pa. Super. 2003) (holding that action for negligent misrepresentation in construction contract that only caused economic harm would be barred by economic loss doctrine); see also *Spivack v. Berks Ridge Corp., Inc.*, 586 A.2d 402 (Pa. Super. 1990).

However, where a building owner seeks damages in a defective construction case for loss of personal property, cleaning costs, rent and lost profits, in addition to damage to the building itself, the tort claims will not be barred by the economic loss doctrine. *Clouser's Auto Body, Inc. v. Jewell Bldg. Systems, Inc.*, 41 Pa. D. & C.4th 271 (Pa. Com. Pl. 1998).

Another important exception exists: the economic loss doctrine does not apply to claims of negligent misrepresentation that come under Restatement (Second) of Torts §552. *Bilt-Rite Contractors v. Architectural Studio*, 866 A.2d 270 (Pa. 2005). However, this exception seems to only apply where the individual whose misrepresentation was relied upon is a professional in the business of designing or building (i.e. architects and other design professionals). See *Rock v. Voshell*, 2005 U.S. Dist. LEXIS 36942, 2005 WL 3557841 (E.D. Pa. 2005). But see *Sovereign Bank v. BJ's Wholesale Club, Inc.*, 395 F. Supp.2d 183 (M.D. Pa. 2005) (applying exception to all negligent misrepresentation cases, not just where individual was professional in business of providing/supplying information).

IX. GIST OF THE ACTION DOCTRINE

The gist of the action doctrine applies when a tort claim arises from a contractual duty. It operates to bar tort claims where the duty breached arises from a contractual obligation, such that a breach of contract action is the proper form of suit. *Bash v. Bell Tel. Co.*, 601 A.2d 825 (Pa. Super. 1992). When a breach of contract could also give rise to an actionable tort “to be construed as in tort . . . the wrong ascribed to the defendant must be the gist of the action, the contract being collateral.” *Id.* at 829. If the claims arise from a breach of contractual duties, and not a breach of duties imposed as a matter of social policy, then they are barred by the gist of the action doctrine. *Quorum Health Resources, Inc. v. Carbon-Schuylkill Community Hosp.*, 49 F. Supp.2d 430 (E.D. Pa. 1999). *However, in terms of insurance coverage and what constitutes an “occurrence” and whether the gist of the action can operate to preclude coverage or negate a duty to defend or indemnity under an insurance policy, the Superior Court has rejected the gist of the action argument, stating that the Pennsylvania Supreme Court has not adopted this doctrine in an insurance coverage context, and the doctrine is not appropriate to solely determine whether there is a duty to defend. Indalex, Inc. v. Nat’l Union Fire Ins. Co.*, 83 A.3d 418 (Pa. Super. 2013). For more on the gist of the action doctrine, please also reference Section XVI, Insurance Coverage for Construction Contracts.

X. RECOVERY FOR INVESTIGATIVE COSTS

There is no case law in Pennsylvania regarding this measure of damages. However, it is unlikely that Pennsylvania courts would allow recovery for such costs, as the long-prevailing general rule is that each party to a lawsuit is responsible for its own costs and fees, absent a statutory rule or exception to the contrary. *See e.g., Merlino v. Delaware County*, 728 A.2d 949, 951 (Pa. 1999); *Koffman v. Smith*, 682 A.2d 1282, 1292 (Pa. Super. 1996).

XI. EMOTIONAL DISTRESS CLAIMS

Except in certain limited circumstances, there can be no claim for negligent infliction of emotional distress in the absence of a physical manifestation of the emotional distress. *Brown v. Philadelphia College of Osteopathic Med.*, 760 A.2d 863, 872 (Pa. Super. 2000). Under Pennsylvania law, damages for emotional distress are generally not recoverable in an action for breach of contract. *Murray v. U. of Pa. Hosp.*, 490 A.2d 839, 842 (Pa. Super. 1985). *See also Spack v. Apostolidis*, 510 A.2d 352, 355 (Pa. Super. 1985); *Ritchey v. Patt*, 636 A.2d 208 (Pa. Super. 1994) (claims for pain and suffering and emotional distress are not considered contract damages); *McIntyre v. Phila. Housing Auth.*, 816 A.2d 1204, (Pa. Commw. 2003) (breach of implied warranty of habitability is a contract claim for which only contract remedies are available)(albeit this was a landlord-tenant case); *Van Scoyoc v. Gen. Foam Corp.*, 7 Pa. D.&C.4th 621, 623 (Blair C.C.P. 1990) (breach of warranty claim seeking personal injury damages does not set forth valid claim).

This is because Pennsylvania law draws a distinction between *general damages* -- those ordinary damages that flow directly from the breach; and *special or consequential damages* -- those collateral losses, such as expenses incurred or gains prevented, which result from the breach. *Ebasco Services, Inc. v. Pennsylvania Power & Light Co.*, 460 F. Supp. 163, 213 n.62 (E.D. Pa. 1978). However, it should be noted that where damage to real property is suffered due to the negligence of another, a homeowner is entitled to be compensated for the discomfort and inconvenience caused him during the period his home is not habitable. *Dussell v. Kaufman Construction Co.*, 157 A.2d 740 (Pa. 1960); *Houston v. Texaco, Inc.*, 538 A.2d 502 (Pa. Super. 1988), *alloc. denied*, 549 A.2d 136.

XII. STIGMA DAMAGES

There is no law in Pennsylvania regarding the recovery of stigma damages. However, diminution of value may be an appropriate element of damages if the damage to the property is permanent. *Rabe v. Shoenberger*, 62 A. 854 (Pa. 1906). *See also Duquesne Light Co. v. Woodland Hills School District*, 700 A.2d 1038 (Pa. Commw. 1997), *appeal denied*, 724 A.2d 936.

Additionally, the U.S. Court of Appeals for the Third Circuit has held that eligibility for stigma damages entails three elements: “(1) defendants have caused some (temporary) physical damage to plaintiffs' property; (2) plaintiffs demonstrate that repair of this damage will not restore the value of the property to its prior level; and (3) plaintiffs show that there is some ongoing risk to their land.” *In re Paoli R.R. Yard PCB Litig. (“Paoli II”)*, 35 F.3d 717, 798 (3d Cir.1994). “*Paoli II* specifically requires proof of some real physical damage to plaintiffs' land, some damage that ‘exists in fact’ as opposed to damage caused by negative publicity alone.” *In re Paoli R.R. Yard PCB Litig.*, 113 F.3d 444, 462–63 (3d Cir.1997). Accordingly, plaintiffs may try to seek umbrage from the Third Circuit’s holding in *Paolii* to support claims for stigma damages.

XIII. ECONOMIC WASTE

The proper measure of damages for injury to land is as follows. Assuming the land is repairable, the measure of damage is the lesser of: (1) the cost to repair, or (2) the market value of the damaged property (before it suffered the damage, of course). If the land is not repairable, the measure of damage is the decline in market value as a result of the harm. Generally, the plaintiff has a duty to present sufficient evidence from which a jury can compute the proper amount of damages with reasonable certainty. *Slappo v. J's Dev. Assocs. Inc.*, 791 A.2d 409, 415 (Pa. Super. 2002).

XIV. DELAY DAMAGES

In contract cases, prejudgment interest is awardable at the legal rate of 6% per annum, but the parties to a contract may agree to a higher rate. 41 P.S. §202. See *Pittsburgh Constr. Co. v. Griffith*, 834 A.2d 572, 590 (Pa. Super. 2003). Statutory post-judgment interest is a matter of right where damages are ascertainable by computation, even though a bona fide dispute exists as to the amount of the indebtedness.

In tort actions, prejudgment interest (a.k.a. delay damages) is awarded pursuant to the provisions of Pennsylvania Rule of Civil Procedure 238, which fixes as the rate for calculating delay damages “the prime rate as listed in the first edition of the Wall Street Journal published for each calendar year for which the damages are awarded, plus 1%, not compounded.” Pa.R.C.P. 238(a)(3).

Regarding breach of contract claims alleging property damage, the Pennsylvania Supreme Court held that Pa.R.C.P. 238 does not permit delay damages in a breach of contract action where the damages were measurable by actual property damages. See *Touloumes v. E.S.C. Inc.*, 899 A.2d 343 (Pa. 2006). The Court stated that, in a breach of contract action, “pre-judgment interest is the appropriate vehicle to secure monies for the delay of relief.” *Id.* at 349.

Under Pennsylvania law, “no damages for delay” clauses are generally enforceable. Typically, an owner bears no responsibility for independent contractor delays, under a contract that contains a “no damages for delay” clause. However, Pennsylvania law recognizes that exculpatory provisions in a contract cannot be raised as a defense where (1) there is an affirmative or positive interference by the owner with the contractor's work, or (2) there is a failure on the part of the owner to act on some essential matter necessary to the prosecution of the work. *Henry Shenk Co. v. Erie County*, 319 Pa. 100, 178 A. 662 (1935). Thus, affirmative or positive interference sufficient to overcome the “no damages for delay clause” may involve availability, access or design problems that pre-existed the bidding process and were known by the owner but not by the contractor. *Coatesville Contractors & Eng'rs, Inc. v. Borough of Ridley Park*, 509 Pa. 553, 506 A.2d 862 (1986) *Commonwealth of Pa., Dep't of Highways v. S.J. Groves & Sons Co.*, 20 Pa.Cmwlth. 526, 343 A.2d 72 (1975) Similarly, an owner cannot insulate itself from a delay damage claim where it fails to perform an essential contractual duty. *Gasparini Excavating Co. v. Pa. Tpk. Comm'n*, 409 Pa. 465, 187 A.2d 157 (1963).

The active or affirmative interference exception has recently been expanded by recent Pennsylvania decisional law. In *John Spearly Constr., Inc. v. Penns Valley Area Sch. Dist.*, 2015 Pa. Commw. LEXIS 337, the Court found that an owner may be liable for the action or inaction of third-party contractors when the owner is ultimately responsible for the scheduling and oversight of those contractors. This holding will likely increase the exposure of project owners who take a more substantial role in the construction process as those owners may now be subject to delay damages from impacted contractors and subcontractors. For contractors and

subcontractors, this holding provides an additional mechanism to trigger delay damages under Pennsylvania law that may otherwise have been precluded by contractual agreement.

XV. RECOVERABLE DAMAGES

A. Direct Damages

The measure of damages for injury to real property is "the cost of repairs where that injury is repairable unless such cost is equal to or exceeds the value of the injured property." *Kirkbride v. Lisbon Contractors, Inc.*, 560 A.2d 809, 812 (Pa. Super. 1989). *See also Matakitis v. Woodmansee*, 667 A.2d 228 (Pa. Super. 1995), *alloc. denied*, 682 A.2d 311. If the cost of repair exceeds the value of the property, "the cost of damages becomes the value of the property." *Kirkbride*, 560 A.2d at 812. If the injury to the property is permanent, "the measure of the damages becomes the decrease in the fair market value of the property." *Id.* *See also Matakitis, supra; Gloviak v. Tucci Const. Co., Inc.*, 608 A.2d 557 (Pa. Super. 1992).

The measure of damages for total loss of personal property is its reasonable value at the time of loss, giving due consideration to the purchase price, the condition of the property at the time of loss, an appropriate depreciation factor and the salvage value of the property. *Denby v. North Side Carpet Cleaning Co.*, 390 A.2d 252, 259 (Pa. Super. 1978). *See also Daughen v. Fox*, 539 A.2d 858 (Pa. Super. 1988), *alloc. denied*, 553 A.2d 967. The measure of damages for repairable damage to personal property is, at the election of plaintiff, the difference between the pre-injury and post-injury value of the property, or the reasonable cost of repair, with allowance for the difference between the pre-injury and post-injury value, and the loss of use. *Kintner v. Claverack Rural Electric Co-operative, Inc.*, 478 A.2d 858 (Pa.1984).

B. Loss of Use

Compensation for loss of use sustained due to the repairable damage to real property is appropriate under Pennsylvania law. *Kincade v. Laurel Courts, Inc.*, 644 A.2d 1268 (Pa. Super. 1994).

C. Punitive Damages

The Pennsylvania Supreme Court has adopted Restatement (Second) of Torts §908(2) with respect to punitive damages. *Feld v. Merriam*, 485 A.2d 742 (Pa. 1984) ("punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others"). Where "the defendant has acted in a merely negligent manner, or even a grossly negligent manner, there is insufficient culpability and awareness by the defendant of the nature of his acts and of their potential results either to warrant punishment or effectively to deter similar future behavior." *Phillips v. Cricket Lighters*, 883 A.2d 439, 445 (Pa. 2005).

To constitute sufficient reckless conduct to create a jury question on the issue of punitive damages, Pennsylvania law requires that the "actor knows, or has reason to know... of facts which create a high degree of risk of physical harm to another, and deliberately proceeds to act, or fail to act, in conscious disregard of, or indifference to, that risk." *Smith v. Celotex*, 564 A.2d 209, 211 (Pa. Super. 1989); *see also SHV Coal, Inc. v. Continental Grain Co.*, 587 A.2d 702, 704-05 (Pa. 1991). The act or failure to act must be intentional, reckless, or malicious. *Smith*, 564 A.2d at 211. Therefore, in determining whether punitive damages should be awarded, "the act, or the failure to act, must be intentional, reckless or malicious." *Phillips*, 883 A.2d at 445. *See also Smith, supra*.

Punitive damages are not recoverable in Pennsylvania in an action based solely upon breach of contract. *Johnson v. Hyundai Motor America*, 698 A.2d 631 (Pa. Super. 1997), *appeal denied*, 712 A.2d 286 (1998). In contract cases, punitive damages are generally not awarded. *Skurnowicz v. Lucci*, 798 A.2d 799, 797 (Pa. Super. 2002). To be entitled to punitive damages on a breach of contract claim, a plaintiff must prove that the defendant's actions must show some "reckless indifference to the rights of others" to warrant such damages. *Id.*

A claim for punitive damages arises out of the underlying cause of action, and absent a viable cause of action, an independent claim for punitive damages may not stand. *Costa v. Roxborough Memorial Hospital*, 708 A.2d 490, 497 (Pa. Super. 1998). Punitive damages cannot be recovered unless the plaintiff recovers compensatory damages. *Houston v. Texaco, Inc.*, 538 A.2d 502, 505 (Pa. Super. 1988).

D. Emotional Distress

Where damage to real property is suffered due to the negligence of another, a homeowner is entitled to be compensated for the discomfort and inconvenience caused him during the period his home is not habitable. *Dussell v. Kaufman Construction Co.*, 157 A.2d 740 (Pa. 1960); *Houston v. Texaco, Inc.*, 538 A.2d 502 (Pa. Super. 1988), *alloc. denied* 549 A.2d 136. However, except in certain limited circumstances, there can be no claim for negligent infliction of emotional distress in the absence of a physical manifestation of the emotional distress. *Brown v. Philadelphia College of Osteopathic Med.*, 760 A.2d 863, 872 (Pa. Super. 2000), *appeal denied*, 781 A.2d 137 (Pa. 2001).

E. Attorney's Fees

Generally, attorney's fees are not recoverable as damages in the absence of a contractual or statutory provision to the contrary, or some other established exception. *See, e.g., Putt v. Yates-American Mach. Co.*, 722 A.2d 217, 226 (Pa. Super. 1998), *alloc. denied*, 737 A.2d 743; *Mosaica Acad. Charter Sch. v. Comm. of Pa., Dept. of Ed.*, 813 A.2d 813, 822 (Pa. 2002); *see also* 42 Pa.C.S. 1726(a)(1).

Additionally, Pennsylvania law permits parties to contractually agree to the recovery of attorney's fees. Generally, where one party expressly contracts to pay the other's fees, such an obligation will be enforced. *Putt v. Yates-American Mach. Co.*, 722 A.2d 217, 226 (Pa. Super. 1998). However, where such an agreement requires that the breaching party must pay the other party's attorney's fees, a court will limit the recovery to *reasonable* attorney's fees, not the actual fees incurred. *McMullen v. Kutz*, 925 A.2d 832, 835 (Pa. Super. 2007). This reasonableness requirement is implicit in such an agreement. *Id.*

F. Expert Fees and Costs

In Pennsylvania, expert fees and costs are not ordinarily recoverable in the absence of a statutory provision. *See, e.g., In re King*, 249 A.2d 552 (Pa. 1969); *Walasavage v. Marinelli*, 483 A.2d 509 (Pa. Super. 1984). *See also* Pa.C.S. 1726.

G. Special Statutory Provisions

Pennsylvania's Procurement Code (also referred to as the Prompt Payment Act), 62 Pa. C.S.A. §§3901 *et seq.*—which applies to public projects—and the Contractor and Subcontractor Payment Act ("CAPSA"), 73 P.S. §§501 *et seq.*—which applies to private work—contain penalty provisions that may be applied against an owner or general contractor for failure to make timely payments to a general contractor or subcontractor respectively. The premise of both the Code and the Act is the performance in accordance with the contract entitles the contractor or subcontractor to its payment. The Act and the Code provide for, in certain circumstances, an award of interest. Whereas the Code permits a Court to exercise its discretion to award an interest penalty of 1% per month, as well as attorney's fees where payments were withheld in bad faith; CAPSA requires a Court to impose a 1% penalty and mandates the award of reasonable attorney's fees.

The Act contains similar provisions in the event that a withholding a payment be found to be arbitrary or vexatious. An Owner/Contractor can withhold payment to a Contractor/Subcontractor only if notice is provided to that party that alleged defects exist in the materials or work performed. A Contractor/Subcontractor is entitled to the full balance due, interest on the balance due, a penalty of one percent per month on the balance due, and attorneys' fees and expenses incurred in attempting to collect the money owed. In general, such penalties will only be awarded to a substantially prevailing party.

A June 2015 decision by the Commonwealth's Supreme Court, *Clipper Pipe & Service, Inc. v. The Ohio Casualty Insurance Co.*, case number 59 EAP 2014, provided further clarity as to CAPSA's applicability to public work's contracts. In *Clipper Pipe*, the Supreme Court held that the statutory protections provided by CAPSA do not apply to public works projects. Prior to the *Clipper Pipe* decision, Pennsylvania Courts remained divided as to whether CAPSA applied to public works projects. However, in light of this decision, it is clear that unpaid contractors and subcontractors only remedies for non-payment are through the Prompt Payment Act, which

does not necessarily guarantee an award of 1% monthly interest as well as reasonable attorney's fees as would be required under CAPSA.

Additionally, in *Scungio Borst & Assocs. v. 410 Shurs Lane Developers, LLC et al.*, 2014 Pa. Super. LEXIS 4527 (Pa. Super. Ct. 2014) the Pennsylvania Superior Court rejected a contractor's assertion that the penalties imposed by CAPSA extend beyond contracting parties. In *Scungio*, a contractor sought to impose CAPSA liability against an owner's agent. After reviewing the decision, an *en banc* panel of the Superior Court determined that the Legislature did not intend to impose the remedies available the act to non-contracting parties and found that the provisions of the act applied to contracting parties only.

Importantly, a recent decision by the Commonwealth's Supreme Court in *Scott Enterprises, Inc. v. City of Allentown*, 142 A.3d 779 (Pa. 2016) specifically provides that the award of attorneys' fees and penalties under the Pennsylvania Prompt Pay Act is discretionary. The Supreme Court's holding in *Scott Enterprises, Inc.* provides Courts with wide latitude in determining whether claimants are entitled to an award of attorney's fees and penalties pursuant to the Prompt Payment Act. This holding may be of significant import in such claims that often involve significant claims for reimbursement of attorney's fees.

There were a number of amendments to the Contractor and Subcontractor Payment Act signed into law in 2018. The amendments include:

- Any contract provision purporting to waive rights afforded under CASPA is unenforceable unless waiver of the right is expressly permitted by CASPA (e.g. CASPA permits parties to modify by contract the CASPA right to interest at a rate of 1% per month)
- For contracts lacking a provision permitting suspension of work for nonpayment, contractors and subcontractors now have a statutory right to suspend work for nonpayment under the following conditions:
 - Payment has not been made within the period of time required by the contract or the statutory period set by CASPA, whichever is applicable;
 - After 30 calendar days have passed since payment was due, written notice of the nonpayment is sent via email or postal service to the person who owes the payment or their authorized agent; and,
 - After 30 calendar days since the written notice of nonpayment was sent, written notice is sent via certified mail (to the person who owes payment or his/her authorized agent) of the intent to suspend performance in 10 calendar days if payment is not made.

- Under this statutory right, work may be suspended no earlier than 70 days after payment was due.
- Parties can contract for a shorter period of time to suspend performance after nonpayment. Conversely, any suspension of work provision that provides for a longer period of time (or does not permit suspension in the event of nonpayment) is unenforceable.
- Good faith withholding of payment now expressly requires written explanation of the reason for the withholding within 14 days of receipt of an invoice.
- The Act expressly provides that failure to provide a written explanation within 14 days will constitute a waiver of the right to withhold and require payment of the invoiced amount in full. The amount of the withholding must be reasonable (i.e. a reasonable estimate of the cost to correct the deficient work or the damages sustained).
- These written notice of deficiencies requirements must also be followed for retainage to be withheld beyond 30 days of final acceptance of the work; otherwise, the right to withhold retainage is waived.
- Delay of payment due to an error in an invoice is now expressly prohibited. CASPA requires written notice of invoice errors to be sent within 10 working days of receipt of an invoice. Once the notice of the error is received by the person who sent the mistaken invoice, payment of the correct invoice amount must be made when due regardless of whether (or when) the invoice is corrected.
- Contractors and subcontractors now have the express right to payment of retainage upon substantial completion if they post a maintenance bond for 120% of the retainage amount.

XVI. INSURANCE COVERAGE FOR CONSTRUCTION CONTRACTS

It is well settled that the interpretation of an insurance contract is a matter of law for the court to decide. *401 Fourth Street v. Investors Ins. Group*, 879 A.2d 166, 171 (Pa. 2005). If the policy language is unambiguous and clear, the court will give effect to the language. *Cresswell v. PNMCI*, 820 A.2d 172, 178 (Pa. Super. 2003).

In Pennsylvania, the duty of an insurer to defend an insured is separate from, and greater than, the insurer's duty to indemnify. *Britamco Underwriters v. Weiner*, 636 A.2d 649, 651 (Pa. Super. 1994). The insurer's duty to defend is determined by the allegations of the complaint, even if the allegations are groundless, false, or fraudulent, if the facts alleged bring the claim within the policy's coverage. *Snyder Heating Co. v. Pennsylvania Mfrs. Ass'n Ins. Co.*, 715 A.2d 483 (Pa. Super. 1998); *General Acc. Ins. Co. of America v. Allen*, 692 A.2d 1089 (Pa. 1997). A duty

to defend “also carries with it a conditional obligation to indemnify in the event the insured is held liable for a claim covered by the policy.” *General Acc.*, 692 A.2d at 1095.

The Pennsylvania Supreme Court has held that where a first party property policy provision covers “damage caused by or resulting from risks of direct physical loss involving collapse of a building or any part of a building,” the policy provides coverage for the imminent collapse of a building. *401 Fourth Street v. Investors Ins. Group*, 879 A.2d 166 (Pa. 2005). The Court declined to define the precise meaning of “collapse,” but stated that the entire phrase must be considered, and the policy language covering the “risks” “involving” collapse is ambiguous and as such provides broader coverage, covering either the actual collapse or imminent falling down of a building or part of a building. *Id.* at 174.

The modern trend around the U.S. is to look at the particular facts of a case, examining whether property damage is present, and whether there was indeed an “occurrence.” *See, e.g., Vandenberg v. Superior Court*, 982 A.2d 229 (Cal. 1999) (commercial liability insurance policy can provide coverage for liability arising out of a contractual relationship).

Indeed, Pennsylvania trial courts seem to have rejected a “black and white” analysis of coverage for contract based claims, choosing instead to focus on whether the facts show property damage (injury to or loss of use of tangible property) caused by an “occurrence” (accidental or unintended). *See, e.g., Nitterhouse Concrete Products v. PMA Ins. Co.*, 67 Pa. D.&C.4th 225 (Franklin County 2004). The court reiterated that whether damage is caused by an accident must be determined from the perspective of the insured. *Id.* at 230, *citing Cardwell v. Chrysler Financial Corp.*, 804 A.2d 18 (Pa. Super. 2002). Thus, the court concluded, the contention that a breach of contract can never be an accident (i.e., an “occurrence”) is unsupported, particularly when, from the perspective of the insured, the damage is neither intended nor expected. *Nitterhouse*, 67 Pa. D.&C.4th at 232.

Kvaerner Metals v. Commercial Union Ins. Co., 908 A.2d 888 (Pa 2006), held that the definition of “accident” required to establish an “occurrence” under liability policies cannot be satisfied by claims based upon faulty workmanship. It does not matter that the insured did not intend for the damage to occur. Such claims do not present the degree of fortuity required by an insurance policy and the court stated that to hold otherwise would turn a policy of insurance into a performance bond. Note that the *Kvaerner* matter had been consolidated with *Freestone v. New England Log Homes* (See 819 A.2d 550 (Pa Super 2003) and the Supreme Court had directed the parties to brief the appropriate tests for whether the actions sounded in contract or tort for purposes of insurance coverage and thus requiring the parties to address the gist of the action doctrine. But the *Freestone* matter settled while on appeal and the Supreme Court noted in a footnote that it saw no need to address the gist of the action doctrine. Thus *Kvaerner* does not specifically embrace a strict view that all brief of contract claims can never be an “occurrence” but rather focuses instead on faulty workmanship not constituting an “occurrence.”

In a recent decision, the Superior Court, while referencing *Kvaerner* and the lack of coverage for faulty workmanship, also specifically concluded that when a complaint alleges liability based upon contractual duties and not “by the larger social policies embodied by the law of torts,” the gist of the action doctrine (*see* Section IX *supra*) precludes coverage for such claims even when the injured party makes a claim for damages to property other than the insured’s work. *Erie Ins. Exchange v. Abbot Furnace Co.*, 2009 PA Super 88 (Pa. Super. 2009).

A recent minority view of the “first manifestation” doctrine also merits special attention. In the case of *Pennsylvania Nat’l Mut. Cas. Ins. Co. v. St. John*, 106 A.3d 1 (Pa. 2014), the Pennsylvania Supreme Court decided that, absent a narrow exception for asbestos-type claims, the proper coverage trigger under a standard Insurance Services Office, Inc. (ISO), commercial general liability (CGL) policy is “first manifestation”—that is, only the policy in effect when “either bodily injury or property damage becomes reasonably apparent” is triggered. This is the minority view. It restricts coverage to a single policy year even when bodily injury or property damage occurs progressively over multiple policy years. Coverage is triggered under the “first manifestation” rule when the damage is reasonably apparent, not when the cause of the damage is recognized as being attributable to the insured’s negligence.

XVII. UNIFORM CONSTRUCTION CODE

Pennsylvania has adopted a Uniform Construction Code (UCC), found at 34 Pa. Code §§ 401-405. The UCC’s provisions provide permit and inspection procedures that apply to commercial and residential construction projects. The UCC requirements for commercial structures, including industrial structures, are found at §§ 403.21 through 403.48. The UCC requirements for residential structures are located in §§ 403.61 to 403.66. The requirements of the UCC pertaining to elevators and other lifting devices are in §§ 405.1 to 405.42.

UCC § 403.21 adopts 11 codes for use throughout Pennsylvania, including the International Building Code 2003, the ICC Electrical Code 2003, and the International Energy Conservation Code 2003. During the initial adoption phase, municipalities in Pennsylvania were allowed to decide whether they would administer and enforce the UCC locally (i.e. opt-in or opt-out). Of Pennsylvania’s 2,565 municipalities, 286 municipalities chose to opt-out. A county by county listing of municipal decisions can be found at www.dli.state.pa.us.

The building process under the UCC begins with the completion and submission of an Application for Building Permit. There are many structures for which a permit is not necessary, including emergency repairs if the application is submitted within three days of the repair; construction of fences not over six feet high, construction of oil derricks, construction of certain sidewalks and driveways, certain swings and other playground structures, certain prefabricated swimming pools, and certain window awnings. “Ordinary repairs” are also generally exempted from the permit requirements.

XVIII. MECHANIC'S LIENS

A. Who May File?

Contractor: Anyone, including architects or engineers, who contracts with the owner of the property to construct, alter, or repair any building or structure or furnishes labor, skill, materials, fixtures, machinery, or equipment reasonably necessary and used in the improvement.

Subcontractor: Anyone who, by contract with contractor, or in contract with a subcontractor who is in contract with a contractor, constructs, alters, or repairs any building or structure or furnishes labor, skill, materials, fixtures, machinery or equipment necessary for an used in the wok. Subcontractor does **not** include an architect or engineer who contracts with the contractor or subcontractor, or a person who contracts with a materialman or subcontractor not in direct contract with the contractor.

a. What Does This Mean?

Mechanics' Liens rights are restricted to the Contractor, the Subcontractors, and those with a direct contract with subcontractors (sub-subcontractors). No one below this level of sub-subcontractors has lien rights, which will leave certain suppliers without lien rights. In other words, in Pennsylvania, lien rights extend to general contractors, subcontractors, and sub-subcontractors (contractors and suppliers who have a direct contract with subcontractors), but not beyond that direct chain of contractors.

B. Priority

The general rule for liens is they are given priority in the order in which they are filed. The first in time filed in the land records will be the "first mortgage," with the first priority to any proceeds from a foreclosure or sale of the property. If another mortgage is filed in the land records later in time, it will be a "second mortgage." If the property is foreclosed, this second mortgage will not receive any proceeds until after the first mortgage has been paid in full.

There are very few exceptions to this "first in time, first in right" general rule. One exception is county real estate tax liens, which will always have priority over other liens no matter when they are filed. Another exception is mechanics' liens that are "inchoate," such as liens in Pennsylvania. The inchoate Pennsylvania mechanics' lien "relates back" to and exists from the moment labor or material is visibly supplied to the property, as long as the claimant eventually perfects the lien. Most liens recorded after work visibly began on the property will be inferior to the mechanic's lien. However, purchase money mortgages and open-ended construction loans have priority over mechanic's liens, regardless of when these mortgages are filed in the land records. *See also* below regarding recent developments on priorities involving open ended mortgages.

Lenders can essentially "hold their place" by recording construction loan that states a maximum future amount. If a construction loan is properly filed, the lender can advance future funds up to the maximum amount of the construction loan without checking for visible commencement of work on the security property. 42 Pa.C.S.A. § 8143. Mortgages held by construction lenders will usually be open ended. "Purchase money mortgages" are used to purchase property. A lender can advance funds to purchase property without checking for visible commencement of work on the security property.

With the exception of purchase money mortgages and construction loans, the Pennsylvania mechanic's lien has priority over all other liens filed with the court after the date of "visible commencement" of work on the property in the case of new construction. 49 P.S. § 1508(a). Where the improvement made is an alteration or repair, the lien is not inchoate and the priority of the mechanic's lien begins as of the date of the filing of the claim. 49 P.S. § 1508(b).

C. Pennsylvania Filing Requirements

Mechanics' Lien claims must be filed in the Prothonotary's Office of the county where the property is situated within **six months** of the claimant's last work.

1. Contents of the Claim

- Name of the claimant and whether they are filing as a contractor or subcontractor.
- The name and address of the owner or reputed owner.
- The date of completion of the claimant's work.
- If filed by a subcontractor, the name of the person with whom the claimant contracted and the dates that the formal notice was given.
- A detailed statement of the kind and character of the labor and materials furnished and the price charged for each; **but** if filed by a contractor pursuant to a contract for an agreed sum, an identification of the contract and a statement of the services and materials provided.
- The amount claimed.
- A description of the improvement and the property subject to the Lien.

2. Contractor Filing Deadlines—49 P.S. § 1502

- Claim must be filed with the Prothonotary of the County in which the property sits within six months of the date that the claimant has completed work.
- Written notice must be provided to the owner within thirty days after filing the claim.

- Claimant must file an affidavit of service of notice with the Court within 20 days of service.
3. Subcontractor Filing Deadlines—49 P.S. § 1501
- 30 days prior to filing claim, subcontractor must give written, formal notice of intention to file claim to owner.
 - **NOTE:** Given the six-month filing deadline, a subcontractor **MUST** provide a formal notice of intention to file a claim to the owner no less than five months after the work has been completed.
 - Formal notice must include:
 - Name of claimant.
 - Name of person with whom claimant contracted.
 - The amount claimed.
 - The general nature and character of the labor or materials furnished.
 - The date of completion of claimant's work.
 - Description of the property.
4. Pennsylvania State Construction Notices Directory and New Lien-Related Notices – 49 P.S. §§ 1501.1-1501.6
- Under Act 142, the Department of General Services was required to create an operational website known as the “State Construction Notices Directory” to “serve as a standardized Statewide system for filing construction notices.” § 1501.1(a).
 - The Directory applies with respect to private construction projects with a total value of at least \$1.5 million.
 - Act 142 provides for four new notices to be used in connection with the Directory.
 - Notice of Commencement (§ 1501.3(a)) – not mandatory, but allows owner a mechanism to limit potential lien claimants. Notice must include:
 - Name, address and email address of contractor;
 - Name and location of searchable project;
 - County in which the searchable project is located;
 - Legal description of the property, including tax ID number of each parcel included in the searchable project;
 - Name, address and email address of the owner;
 - If applicable, name, address and email address of the surety;
 - Unique identifying number that is assigned to the Notice of Commencement pursuant to § 1501.1(e)(1).

- Notice of Furnishing (§ 1501.3(b)) – If the project owner files a Notice of Commencement, a subcontractor that performs work or services, or provides materials, must file a Notice of Furnishing to preserve lien rights. The Notice of Furnishing must be filed within 45 days and must contain the following:
 - General description of the labor or materials furnished;
 - Name and address of the person supplying the services or items;
 - Name and address of the person that contracted for the services or items;
 - Description sufficient to identify the searchable project, based on the description in the Notice of Commencement.
- Notice of Completion (§ 1501.4 (a)) – Optional/for informational purposes only. Owner may file a notice in the Directory within 45 days of actual completion of work on a searchable project. Actual completion means:
 - Issuance of occupancy permit accompanies by a cessation of all work on the project; or
 - Cessation of all work on the project for 30 consecutive days provided that work is not resumed under the same contract.
- Notice of Nonpayment (§ 1501.4(b)) – Optional/for informational purposes only. Subcontractor who has not received full payment for work, or for goods or services, may file a Notice of Nonpayment. Failure to file, however, does not affect or limit rights under the Act.

D. Owners Have No Automatic Defense of Payment

There is no automatic defense of payment for the Pennsylvania project owner. That is, the owner can be required to pay for the project twice. Even if the owner has paid the general contractor in full, a subcontractor will be able to establish a lien and eventually foreclose on the property. The burden is on the owner to make sure that all subcontractors are paid.

An owner can create a defense of payment by filing a copy of the general contract or a stipulation in the prothonotary's (clerk's) office before commencing construction. 49 P.S. § 1405. This will limit each subcontractor to a pro-rata share of money still owed the general contractor. Id. The importance here is that a subcontractor has an extra layer of protection.

Accordingly, the Formal Notice required of a subcontractor is for the protection of the owner, who, upon receipt of notice, can withhold funds from the contractor in order to pay the subcontractor's claim. 49 P.S. § 1701(d). For this reason, it is also to a claimant's benefit to send a notice as soon as possible. If an owner can withhold payment from the contractor, it is more likely the claimant will be paid without the time and expense of filing suit to enforce the lien claim. An owner will fight a lien claim much harder if the owner faces the possibility of paying for the project a second time.

As previously stated, once an owner has been served with a notice of intention to file a claim, the owner is allowed to withhold funds from the contractor. Id. The owner can require the contractor to promptly settle or discharge the claim. 49 P.S. §§ 1602, 1603.

An owner can create a defense of payment by filing a copy of the general contract or a stipulation in the prothonotary's (clerk's) office before commencing construction. 49 P.S. § 1405. This will limit each subcontractor to a pro-rata share of money still owed the general contractor. Id.

E. RECENT DEVELOPMENTS

1. Act 142

The biggest changes to Pennsylvania's Mechanic's Lien Law over the past year arise out of the enactment of Act 142, which became effective on November 13, 2014, but had its most tangible impact beginning December 31, 2016. The Act required the Department of General Services to create a website by that date to host a "State Construction Notice Directory," which provides a "standardized Statewide system for filing construction notices" and which is now operational. Along with the creation of the Directory, the Act provides for four new types of lien-related notices that can affect the rights of parties to private construction contracts with a total value of at least \$1.5 million.

Under Section 1501.3(a), a project owner can now file a Notice of Commencement prior to the commencement of labor or work, or the furnishing of materials, that may give rise to a mechanic's lien. Where a notice is properly filed in the directory, and a copy is conspicuously posted at the project site before work commences, the project owner can effectively limit the universe of potential lien claimants. A subcontractor that performs work or services, or provides materials, must file a Notice of Furnishing to preserve its lien rights. The Notice of Furnishing must be filed within 45 days after first performing work or services or first providing materials.

The Act also provides that upon completion of the project, the owner may file a Notice of Completion, and a subcontractor who has not received full payment for work, services, or materials may file a Notice of Nonpayment. These notices are entirely optional, and a subcontractor does not waive its rights by failing to file this notice.

Finally, the Act makes certain acts unlawful in order to protect subcontractors and material providers from attempts by a project owner to discourage use of the directory for a Notice of Furnishing. Under Section 1501.6, it is unlawful for an owner "to suggest, request, encourage or require that a subcontractor not file a Notice of Furnishing as a condition of entering into, continuing, receiving or maintaining a contract for work or furnishing of materials

on a searchable project.” A violation of this provision is a misdemeanor of the second degree and also affords the subcontractor a civil cause of action.

2. *Babich v. Buffalo Wild Wings*, 2017 Pa. Super. Unpubl. LEXIS 200 (Pa. Super. Jan. 18, 2017)

This unpublished, non-precedential decision, stands as a stark reminder that the notice and service requirements of Pennsylvania’s Mechanic’s Lien law requires strict compliance to avoid risking the loss of a claim. The Pennsylvania Superior Court upheld a Washington County Court of Common Pleas decision to dismiss a civil complaint and mechanic’s lien claim for failure to obtain proper service pursuant to 49 P.S. § 1502. In this matter, a contractor subcontracted certain plumbing work to Appellant Babich in connection with renovations to a commercial building. Appellant claimed it was still owed a balance for labor and materials furnished to the project owner. Babich filed his mechanic’s lien action *per se*. That action was dismissed based on preliminary objections asserting that Babich failed to comply with the notice and service requirements under Section 1502. The court permitted Babich leave to amend so that he could procure the services of an attorney and attempt to cure.

With assistance of counsel, Babich filed an Amended Complaint, which drew the same preliminary objections based on defective service. Section 1502 required, among other things, that service of the notice of filing of a claim “shall be made by an adult in the same manner as a writ of summons in assumpsit, or if service cannot be so made then by posting upon a conspicuous public part of the improvement.” The Superior Court noted that it has long interpreted this language to require service in person by the Sheriff, to the extent practicable, which Babich failed to do even after retaining counsel.

In affirming the trial court’s decision to dismiss without further leave to amend, the court stated that “to protect a Mechanic’s Lien, it is essential to adhere strictly to the statutory notice requirements.” *Id.* at *6 (internal citations omitted). The Court rejected appellant’s argument that the substantial compliance doctrine salvages the claim, because the doctrine “does not apply where the actual service of notice, as here, is defective.” Because the defect was with respect to the manner of service, not the form of the notice, the substantial compliance doctrine was inapplicable. *Id.* at *7.

3. *Schell v. Murphy*, 2016 Pa. Super. LEXIS 786 (Pa. Super. Dec. 23, 2016)

In this action, the Pennsylvania Superior Court resolved an issue over whether a party to a construction contract who was not an owner is an indispensable party in a mechanic’s lien action. Schell, a contractor, brought suit against Murphy, the owner of residential property, to assert a mechanic’s lien claim for work performed in installing underground drainage and sewage lines and to erect a stone masonry retaining wall, steps, and walkways. Schell allegedly was directed to leave the premises after substantially all improvements were complete and filed a claim for a mechanic’s lien for unpaid amounts, plus interest and costs. *Id.* at *2.

Murphy filed preliminary objections to the mechanic's lien claim on the grounds that claimant had failed to join an indispensable party – Mr. Murphy's wife. Ms. Murphy was a party to the underlying contract, but was not an owner of the property. The trial court held that because Ms. Murphy was an indispensable party, and because she could not be joined under the statute, the mechanic's lien claim must be dismissed. Schell appealed, and the Superior Court reversed.

The Superior Court held that the right to a mechanic's lien is purely a creature of statute and is only available if the conditions of the statute are strictly followed. *Id.* at *4 (internal citations omitted). The statute provides that the lien must include, among other things, "the name and address of the owner or reputed owner." *Id.* The Court held that the trial court improperly conflated the rights and remedies available in a mechanic's lien claim and those available in an action on the contract itself. Because a mechanic's lien action is distinct from a breach of contract action, the trial court's conclusion that Ms. Murphy was indispensable was error. "The statute does not require that the mechanics' lien claimant name all parties to the contract to satisfy the requirements set forth in the mechanics' lien statute; it requires only that the claimant name the owner or reputed owner of the property." *Id.* at *6. The Court noted that to hold otherwise would make it impossible to file a mechanic's lien claim on a property where the contractor entered into a contract with anyone other than, or in addition to, the property owner. *Id.*

4. BRICKLAYERS OPINIONS:

a. Pennsylvania Superior Court Opinion

In 2012, the Superior Court ruled in the case of *Bricklayers of Western Pennsylvania Combined Funds, Inc. v. Scott's Development Co.*, 41 A.3d 16 (Pa. Super. 2012). In *Bricklayers*, the Superior Court held that the trustees of a union's health and welfare funds could assert mechanic's liens under Pennsylvania law where a general contractor had not paid benefits required by a collective bargaining agreement ("CBA"). In so holding, the Superior Court found that the under the applicable rules of statutory construction, and contrary to decades of case law to the contrary, the substantive provisions of the Pennsylvania Mechanic's Lien Law, which included the definition of "subcontractor", were to be "liberally construed".

In *Bricklayers*, general contractor Pustelak was hired by Scott's to perform work on a project. Pustelak had previously entered into a collective bargaining agreement ("CBA") with Bricklayers and Trowel Trades International, Local No. 9 ("Union"). The CBA covered work to be performed within the Union's jurisdiction as specified in the agreement and sets forth exactly what type of work the Union's members were authorized to perform. Pursuant to the CBA, contractor Pustelak was to pay benefits to Bricklayers of Western Pennsylvania Combined Funds, Inc., ("Trustee") for each hour of labor performed by the Union's members. The CBA incorporated this trust agreement between the Union and the Trustee, and under the trust

agreement the Trustee was the authorized agent to collect the contributions on behalf of the Union members.

The Union members performed work on Defendant/Property owner Scott's property under the contract with Pustelak, but Pustelak did not pay the Trustee the required contributions under the CBA. Thereafter, the Trustee filed a Mechanics' Lien Claim against Defendant Scott's, alleging that the Union's members performed services that were incorporated into or utilized for the improvement of the property. Additionally, the Trustee claimed that the Union's employees were subcontractors of Pustelak pursuant to the CBA. The main issue, therefore, was whether a Union Trustee has standing to file a mechanics' lien against a property owner based on a general contractor's alleged failure to make contributions under a CBA on behalf of his employees to a fund that pays for union workers' benefits.

Scott's filed preliminary objections in the nature of a demurer, arguing that the Trustee could not assert a mechanics' lien claim on behalf of the Union's members because the Union's members themselves were not "subcontractors" as defined by the Mechanics' Lien Law. Scott's argued that the Union's members were employees and/or laborers of contractor Pustelak, as opposed to "subcontractors."

The Court of Common Pleas of Erie County granted the preliminary objections. The trial court found that the Union's employees were not subcontractors because they were employees of general contractor Pustelak. Further, collective bargaining agreements were not subcontractor agreements, but employment contracts that were unrelated to "improvements" on real property. The trial court also found that because the Trustee did not perform work on or furnish materials to a project, he lacked standing to bring the claim. In granting Scott's preliminary objections, the court strictly interpreted the Mechanics' Lien Law.

On appeal, the Superior Court ultimately held that the Trustee of a union employee benefit fund had standing to file a mechanics' lien claim against the property of a developer in order to recoup unpaid benefit contributions by their employer owed to the Union. The Court held that the Union's employees were subcontractors pursuant to the CBA. The Court reasoned that since the Trustee "stood in the shoes" of the union members, the Trustee could be considered a subcontractor under the mechanics' Lien Law. The Court stated:

Although a strict compliance standard may be used to determine certain issues of notice and/or service, a *liberal construction* of the definition of "subcontractor" is necessary to effectuate the Mechanics' Lien Law's remedial purpose of protecting prepayment of labor and materials. *1 Pa. C.S. 1928(c)* requires a liberal interpretation, and also the notice and service requirements of the Mechanics' Lien Law pertain to the creation and perfection of a lien claim (procedural requirements), while the definition of "subcontractor" relates to the substantive scope of the statute. If the Mechanics' Lien Law is to be construed to advance its remedial purpose, the scope of the statute's

protection should receive a liberal interpretation, especially when it involves defining the class of available lien claimants.

Bricklayers, 41 A.3d at 28 (emphasis added)

The Superior Court therefore, for the first time, declared that the Mechanics' Lien Law is a remedial statute that should be liberally construed to protect payments for labor and materials, while still holding that the procedural aspects of the law will still be strictly construed. In doing so, the Court found that the relationship between contractor Pustelak and the Union created an implied contract by the Union to perform labor on Scott's property pursuant to the CBA, thus making the Union a "subcontractor." Because the CBA included the trust agreement to fund benefits, the Court reasoned that the Trustee of the benefit plan had standing to assert the claim for payment on behalf of the workers.

The Superior Court's decision in *Bricklayers* certainly expanded the scope of the Mechanics' Lien Law and jettisoned the "strict compliance" construction that had previously been prevalent in determining issues presented under the law. Judges Olson and Gantman filed dissenting opinions, both finding the majority opinion contrary to the intent of the Mechanics' Lien Law.

b. Pennsylvania Supreme Court Opinion

The Pennsylvania Supreme Court granted a Petition for Allowance of Appeal in *Bricklayers of W. Pa. Combined Funds, Inc., v. Scott's Dev. Co.*, specifically to address several key issues that would have long term effects on the application and disposition of Mechanics' Liens in Pennsylvania:

- (1) Whether the Superior Court in *Bricklayers* erred in concluding that portions of the Mechanics' Lien Law should be liberally construed;
- (2) Whether the Superior Court erred in finding that purported contracts implied in fact control the parties' rights under the Mechanics' Lien Law, not the express contract which fails 49 P.S. 1201(5).
- (3) Whether even a liberal construction of portions of the Mechanics' Lien Law would permit an employee of a contractor to assert a claim as a "subcontractor."

On April 17, 2014, the Pennsylvania Supreme Court issued its unanimous decision in *Bricklayers of W. Pa. Combined Funds, Inc., v. Scott's Dev. Co.*, 90 A.3d 682 (Pa. 2014) by which it reversed the Superior Court. In its opinion the Court reiterated that it allowed review to consider: "whether the Superior Court erred in concluding that the 1963 [mechanics lien] Act should be liberally construed; whether even a liberal construction of the act would permit an employee of a contractor to assert a claim as a subcontractor; and whether the Superior court erred in sua sponte finding that implied-in-fact contracts control the parties' rights under the act." *Id.* At 687.

It had long been held that the terms of the Pennsylvania Mechanics Lien Law were subject to strict construction as a statute in derogation of common law, until a majority of the Superior Court stated that the decisions so stating improperly relied on case law from the Supreme Court interpreting the 1963 Mechanic Lien Act's predecessor statute of 1901. *Bricklayers of W. Pa. Combined Funds, Inc., v. Scott's Dev. Co.*, 41 A 3d at 24. In that Superior Court decision, the judges pointed out that the rule of strict construction was no longer applicable to statutes enacted after 1937 under the Pennsylvania Statutory Construction Act. 1 Pa.C.S. §1928(a).

To recap, in *Bricklayers*, the general contractor ("G.C.") was hired to perform work on a project. The G.C. had previously entered into a collective bargaining agreement ("CBA") with Bricklayers and Trowel Trades International, Local No. 9 ("Union"). The CBA covered work to be performed within the Union's jurisdiction as specified in the agreement and sets forth exactly what type of work the Union's members were authorized to perform. Pursuant to the CBA, contractor was to pay benefits to Bricklayers of Western Pennsylvania Combined Funds, Inc., ("Trustee") for each hour of labor performed by the Union's members. The CBA incorporated this trust agreement between the Union and the Trustee, and under the trust agreement the Trustee was the authorized agent to collect the contributions on behalf of the Union members.

The Union members performed work on Defendant property under the contract with the G.C., but the G.C. did not pay the Trustee the required contributions under the CBA. Thereafter, the Trustee filed a Mechanics' Lien Claim against Defendant, alleging that the Union's members performed services that were incorporated into or utilized for the improvement of the property. Additionally, the Trustee claimed that the Union's employees were subcontractors of the G.C. pursuant to the CBA. The main issue, therefore, was whether a Union Trustee has standing to file a mechanics' lien against a property owner based on a general contractor's alleged failure to make contributions under a CBA on behalf of his employees to a fund that pays for union workers' benefits.

Defendant filed preliminary objections in the nature of a demurer, arguing that the Trustee could not assert a mechanics' lien claim on behalf of the Union's members because the Union's members themselves were not "subcontractors" as defined by the Mechanics' Lien Law. Defendant argued that the Union's members were employees and/or laborers of the G.C., as opposed to "subcontractors."

The Court of Common Pleas of Erie County granted the preliminary objections. The trial court found that the Union's employees were not subcontractors because they were employees of general contractor. Further, collective bargaining agreements were not subcontractor agreements, but employment contracts that were unrelated to "improvements" on real property. The trial court also found that because the Trustee did not perform work on or furnish materials to a project, he lacked standing to bring the claim. In granting Defendant's preliminary objections, the court strictly interpreted the Mechanics' Lien Law.

On appeal, the Superior Court ultimately held that the Trustee of a union employee benefit fund had standing to file a mechanics' lien claim against the property of a developer in order to recoup unpaid benefit contributions by their employer owed to the Union. The Court held that the Union's employees were subcontractors pursuant to the CBA. The Court reasoned that since the Trustee "stood in the shoes" of the union members, the Trustee could be considered a subcontractor under the mechanics' Lien Law.

By its April 17, 2014 decision, the Pennsylvania Supreme Court reversed the Superior Court, which found that the Mechanic's Lien Act should be liberally construed. However, the Supreme Court took a narrow approach in its opinion. Rather than state that the Superior Court erred in giving a liberal interpretation to the Act, the Supreme Court limited its review to determining whether the term "subcontractor" could reasonably be interpreted to include union employees of the general contractor. In undertaking this review, the Supreme Court engaged in a traditional statutory construction analysis, first examining whether the term "subcontractor" was clear on its face or ambiguous, and then determining what meaning the legislature had in mind when it used the term "subcontractor" in the Mechanic's Lien Act of 1963.

Although the Pennsylvania Supreme Court reversed the Superior Court, finding that the term "subcontractor" was not subject to the meaning ascribed to it by the Superior Court; nowhere in its opinion does the Supreme Court expressly reaffirm that the Mechanic's Lien Act must be "strictly construed". It remains open to debate whether any portion of the Superior Court's reasoning applying a "liberal construction" to substantive aspects of the Mechanic's Lien Act remain valid.

5. PROCEDURE TO ENFORCE MECHANIC'S LIENS:

In August of 2014, the Pennsylvania Supreme Court, at 97 A.3d 739, granted a Petition for Allowance of Appeal from the Superior Courts unpublished opinion in Terra Technical Services, LLC. v. River Station Land L.P., 82 A. 3d 1084 (Pa. Super. 2013). The issues to be considered on appeal are limited to:

- a. Whether the Superior Court committed an error of law in upholding the Trial Court's Order in sustaining the preliminary objections of Respondent and striking the complaint in an action to obtain judgment on the mechanics' lien claim for the failure of Petitioner to file the complaint under a separate court term and number from that of the mechanics' lien claim under the Mechanics' Lien Law 49 P.S. § 1101, et seq.
- b. Whether the Mechanics' Lien Law 49 P.S. § 1101, et seq., requires a claimant filing a complaint to enforce a mechanics' lien to file such a complaint under a term and number separate from the term and number assigned to the mechanics' lien itself.

In *Terra Technical*, the Superior Court held that actions to compel judgment on mechanic's liens must be filed separately from the liens themselves.

The demolition company that had brought the suit had relied on the Bricklayers opinion from the Superior Court in 2012, arguing that the Mechanic's Lien Law should be interpreted liberally, thus allowing its case to survive. But the Superior Court disagreed.

Lien claimant Terra Technical Services had filed 17 mechanic's liens in 2010 totaling just over \$900,000 against a property owner. It later filed civil action complaints under the same docket numbers as the liens to get judgments on them. The trial court struck its complaints and the company appealed to the Superior Court.

According to the three judge panel of the Superior Court, "An action does not commence by the filing of a mechanic's lien claim". "Likewise, where one files a mechanic's lien claim and then files a complaint in the same proceeding, an action does not commence. As such, Terra's argument that under a joint reading of Mechanic's Lien Law and the Rules of Civil Procedure, the statute and the rules do not require the initiation of a new action under a separate term and number to enforce a lien claim is erroneous and misguided."

According to the court's opinion in *Terra Technical*, the rules governing that law state that an action for a mechanic's lien starts with the filing of a complaint, not the filing of the lien.

Looking to *Bricklayers of Western Pennsylvania Combined Funds v. Scott's Development*, which was decided by the Superior Court in 2012, Terra argued that "a liberal construction of the law should be applied to the matter," Superior Court judge Ott said in her opinion. She was joined by President Judge Susan Peikes Gantman and Judge Cheryl Lynn Allen. "In this regard, Terra asserts the Mechanic's Lien Law and the Rules of Civil Procedure do not entail the initiation of a new action under a separate term and number to enforce a lien claim but 'simply require the filing of a complaint with the prothonot [ar] y'".

The appeals court relied heavily on the reasoning of the trial court, with which it agreed. Its opinion quoted at length from the trial court, which had explained that the Pennsylvania Rules of Civil Procedure defines the words "claim" and "action" differently, with "claim" meaning the filing of a mechanic's lien and "action" meaning a complaint filed to get a judgment on the lien. The filing of that complaint marks the beginning of an action, the court explained.

"Thus, it is the complaint or agreement for an amicable action that starts or begins the action. This language is inconsistent with the contention that the complaint is to be filed as part of the already existing claim. Filing the complaint as part of the claim proceeding would not be starting or beginning anything," Ott said, quoting from the trial court opinion.

The Court continued: "Moreover, Terra's filing of the 17 identical mechanic's liens on March 3, 2010, did not constitute 'commencement' of this action against River Station. Further, Terra's subsequent filing of 17 identical complaints in civil action to obtain judgment on the mechanic's liens on March 2, 2012, under the same filing numbers as the mechanic's liens, also did not 'commence' the action. Accordingly, Terra did not comply with the procedural requirements of the Mechanic's Lien Law, and, therefore, it has not commenced actions to obtain judgment upon the mechanic's lien claims filed."

The court also dismissed Terra's argument that Bricklayers would confer liberal interpretation of the mechanic's lien statutory construction to such a degree that the company wouldn't have to file a complaint separately from the lien in order to start the action.

"Terra's argument that, based on Bricklayers, the Mechanic's Lien Law may only be viewed through the lens of liberal construction is erroneous," Ott said. "Furthermore, Bricklayers is distinguishable from the present matter as it applied a liberal construction to the substantive scope of the statute and did not expand such interpretation to the procedural requirements of the statute."

6. ACT 117 OF 2014

On July 9, 2014, Act 117 of 2014 was passed, which amends the Pennsylvania Mechanics' Lien Law, 49 P.S. 1101, et seq., in two significant ways:

a. Priority of Mechanic's Liens v. Open Ended Mortgages.

Initially, the Pennsylvania Mechanic's Lien Law was amended to provide that mechanic's liens are subordinated to any open-end mortgage that is recorded subsequent to the commencement of construction if at least 60% of the proceeds of the mortgage are used to pay construction costs.

Under prior law, a mechanic's lien filed for work commenced prior to the recording of an open ended mortgage was not subordinate to the mortgage if any of the proceeds were used for any purpose other than erection, construction, alteration or repair of the mortgaged property. See *Commerce Bank v. Kessler*, 46 A.3d 724 (Pa. Super. 2012).

In addition to providing that a portion of loan proceeds may be used for purposes other than construction costs, the new law has added an expansive definition of "costs of construction, which now includes all costs, expenses and reimbursements pertaining to erection, construction, alteration, repair, mandated off-site improvements, government impact fees and other construction-related costs, including, but not limited to:

- costs, expenses and reimbursements in the nature of taxes;
- insurance;
- bonding;

inspections;
surveys;
testing;
permits;
legal, architect, engineering, consulting, accounting, management and utility fees;
tenant improvements;
leasing commissions;
payment of prior filed or recorded liens or mortgages, including mechanics' liens;
municipal claims;
mortgage origination fees and commissions;
finance costs;
closing fees;
recording fees;
title insurance or escrow fees; or
any similar or comparable costs, expenses or reimbursements related to an improvement, made or intended to be made, to the property.

b. Restrictions on Mechanic's Liens on Residential Properties.

Under the new Act 117 law, an unpaid subcontractor on a residential property no longer has lien rights if all three of the following conditions are satisfied:

- a. The property owner or tenant has paid the full contract price to its general contractor;
- b. The property is or is intended to be used as the owner's or tenant's residence; and
- c. The property in question is a one or two unit residential property or townhouse.

In other words, this amendment protects homeowners from having to pay twice for the same work (e.g., where the owner pays the general contractor but the general contractor fails to pay its subcontractor).

The new law also includes a procedure through which an owner can discharge or reduce the amount of the mechanics' lien by either a contractor or subcontractor by petitioning the court and proving that he or she has paid all or part of the contract price to the general contractor.

XIX. SURETIES

At the most basic level, a surety bond is a contract – often required under a contract or subcontract – that governs the legal relationship between a principal (contractor), a surety (typically an insurer), and an obligee (an owner or general contractor), in which the surety guarantees that the principal in the bond will perform the obligated duties that are outlined in

the bond. When these duties are fulfilled, the bond is at that point considered void. However, if the duties are not fulfilled the bond will remain in full force and effect.

Note that Suretyship is distinguishable from insurance. Suretyship is not strictly a form of insurance. The suretyship relationship is a three-party relationship (surety, principal and obligee). In an insurance contract, there are only two parties (insurer and insured). In an insurance relationship, the insurer undertakes to indemnify the insured against loss as a result of an unknown or contingent event. In a suretyship relationship, the surety undertakes to answer for the debt or default of the principal.

If the principal does not perform the duties outlined in the bond, the principal or the surety are liable on the bond. This liability is “joint and several” meaning that the principal or the surety, or both can be sued on the bond and held accountable for the entire liability.

A. Performance Bonds

A performance bond protects the owner against the risk of default on a construction contract. A performance bond provides available funds to complete the principal's contract should the principal be in default of the performance that is owed to the obligee. The surety's obligation tracks that of the principal under the bonded contract up to the penal sum of the bond, subject to the specific terms and limitations in the bond, and is conditioned upon the principal's material default of its performance obligations under the bonded contract.

1. Pennsylvania Little Miller Act Bonds

The statutory bonding requirements for Pennsylvania public works projects are set forth in the Pennsylvania Public Works Contractors' Bond Law of 1967, 8 P.S. §§ 191 et seq. ("PA Bond Law") and in Part I of the Commonwealth Procurement Code, 62 Pa. C.S.A. §§ 101 et seq. ("PA Procurement Code"), which was enacted in 1998. Prior to the adoption of the PA Procurement Code in 1998, the PA Bond Law was the controlling statute with regard to bond requirements for all public bodies in Pennsylvania. As a result of the enactment of the PA Procurement Code, the PA Bond Law only applies to public projects that are not with Commonwealth purchasing agencies (e.g. municipalities, school districts, municipal authorities, etc.). The PA Procurement Code applies to public contracts with a Commonwealth purchasing agency.

For projects subject to the PA Bond Law (contracts exceeding \$10,000 for the construction, reconstruction, alteration or repair of any public work not with a Commonwealth purchasing agency), a contractor must furnish to the contracting body a performance bond in the amount of 100% of the contract amount, conditioned upon the faithful performance of the contract in accordance with the plans, specifications and conditions of the contract. 8 P.S. § 193.1(a)(1). For projects subject to the PA Procurement Code involving contracts between \$25,000 and \$100,000, the contractor must provide a performance bond or other acceptable

security in an amount equal to at least 50% of the contract price as the purchasing agency, in its discretion, determines is necessary to protect the interests of the Commonwealth. 62 Pa. C.S.A. § 903(a). For projects subject to the PA Procurement Code involving contracts in excess of \$100,000, the contractor must provide a performance bond or other acceptable security in an amount equal to 100% of the contract price. 62 Pa. C.S.A. § 903(a)(1). Both the PA Bond Law and the PA Procurement Code provide that the performance bond shall be solely for the protection of the purchasing agency which awarded the contract. 8 P.S. § 193.1(a)(1); 62 Pa. C.S.A. § 903(b).

2. Private Project Bonds

An owner on a private project may require a contractor to provide a performance bond for a construction project even though it is not required by statute. No statutes in the Commonwealth of Pennsylvania require performance bonds on private projects. Performance bonds on private projects vary in form and need to be examined carefully to determine the rights of the parties.

B. Payment Bonds

A payment bond is also known as a labor and material bond. It is a contractual guarantee to the owner-obligee that the surety obligor will pay labor and material suppliers and subcontractors should the contractor-principal fail to pay. A payment bond limits claimants on the bond to those having a direct contract with the principal or with a subcontractor of the principal. Generally, an owner-obligee cannot make a claim against a payment bond.

1. Pennsylvania Little Miller Act Bonds

The statutory bonding requirements for Pennsylvania public works projects are set forth in the Pennsylvania Public Works Contractors Bond Law of 1967, 8 P.S. §§ 191 et seq. ("PA Bond Law") and in Part I of the Commonwealth Procurement Code, 62 Pa. C.S.A. §§-22- 101 et seq. ("PA Procurement Code"), which was enacted in 1998. Prior to the adoption of the PA Procurement Code in 1998, the PA Bond Law was the controlling statute with regard to bond requirements for all public bodies in the Commonwealth of Pennsylvania. As a result of the enactment of the PA Procurement Code, the Bond Law only applies to contracts for public projects that are not with Commonwealth purchasing agencies (e.g. municipalities, school districts, municipal authorities, etc.). The PA Procurement Code applies to public contracts with a Commonwealth purchasing agency.

For projects subject to the PA Bond Law (contracts exceeding \$10,000 for the construction, reconstruction, alteration or repair of any public building or other public work or public improvement), the contractor must furnish to the contracting body a payment bond in the amount of 100% of the contract amount or "financial security" equal to 100% of the contract amount. 8 P.S. § 193.1.

For projects subject to the PA Procurement Code involving contracts between \$25,000 and \$100,000, the contractor must provide a payment bond or other acceptable security in an amount equal to at least 50% of the contract price. For projects subject to PA Procurement Code involving contracts in excess of \$100,000, the contractor must provide a payment bond or other acceptable security in an amount equal to 100% of the contract price. 62 Pa. C.S.A. § 903(a).

2. Private Project Bonds

An owner on a private project may require a contractor to provide a payment bond for a construction project even though it is not required by statute. Payment bonds on private projects vary in form and need to be examined carefully to determine who is entitled to recover, the scope of the surety's obligation, and any conditions precedent to recover under it.

C. Asserting a Performance Bond Claim

1. Pay if Paid

A “pay if paid” clause is a payment clause that states that the contractor is obligated to pay its subcontractors *only if* the contractor receives payment from the owner. In other words, if the owner never pays the contractor, the contractor has no duty to pay you. Pennsylvania courts view a pay if paid clause as a “condition precedent.” This simply means that payment to the contractor by the owner is one of many conditions that must be satisfied before any payment is due to the subcontractor. Just as you would not be entitled to payment if you did not perform the work, you would not be entitled to payment if the owner never paid the contractor. When this type of payment clause appears in a subcontract, the owner’s payment to the contractor is added to the list of conditions, such as satisfactory performance of the work and submission of an application for payment, that must be fulfilled before the subcontractor is entitled to payment.

2. Pay When Paid

A “pay when paid” clause is a payment clause that states that the contractor is obligated to pay its subcontractors following receipt of payment from the owner. In other words, if the owner delays three months in paying the contractor, the contractor has no duty to pay you during that period of delay. Pennsylvania courts view a pay when paid clause as a “timing mechanism.” This means that payment by the owner triggers the timing of when the contractor must pay you. When this type of payment clause appears in a subcontract, the owner’s payment to the contractor is an event that starts running the clock on when the contractor must pay the subcontractor. In general, the subcontractor must be paid pursuant to the terms of the subcontract. If the subcontract does not contain payment terms, then the subcontractor must be paid within a reasonable period of time.

3. Distinction Between Pay if Paid versus Pay When Paid

The difference between these two types of payment clauses is significant and highlights the need to carefully review subcontracts with your attorney. Where there is a “pay if paid” clause in a subcontract, the subcontractor and the contractor share the risk that the owner will fail to pay. If the owner fails to pay the contractor, it is unlikely that the subcontractor will succeed on a claim against the contractor for payment.

By contrast, where there is a “pay when paid” clause, the subcontractor and the contractor do not share the risk of owner non-payment. Because a “pay when paid” clause controls only the timing of payment, not whether any payment is due, Pennsylvania courts generally allow a subcontractor to sue a contractor for non-payment where a reasonable amount of time has passed following the subcontractor’s demand.

In Pennsylvania, “pay when paid” clauses are better for subcontractors. This is because the courts recognize that where there is a “pay when paid” clause rather than a “pay if paid” clause, the contractor still has a duty to pay the subcontractor even where the owner defaults. Because Pennsylvania courts view these clauses differently, and because they can look similar, it is important to carefully review your subcontract with a Pennsylvania attorney who can properly advise you as to the risk of non-payment if you enter into the subcontract.

About the Authors

Louis J. Vogel, Jr., an associate of Sweeney & Sheehan, graduated from the University of Pennsylvania in 2005 and received his J.D. from the Villanova University School of Law in 2009. Mr. Vogel is admitted to practice before the state courts in both Pennsylvania and New Jersey as well as the United States District Court for New Jersey and the United States District Court for Eastern Pennsylvania.

Denise M. Montgomery is a Shareholder at Sweeney & Sheehan, P.C. and focuses her practice in the area of construction defect, representing prime contractors and sub-contractors in complex construction defect claims throughout Pennsylvania and New Jersey. She also has extensive expertise in the areas of employment law, professional liability, and general liability. Ms. Montgomery is experienced in all aspects of litigation, including discovery, mediation, contractual and non-binding arbitration, and trial.

This Compendium outline contains a brief overview of certain laws concerning various litigation and legal topics. The compendium provides a simple synopsis of current law and is not intended to explore lengthy analysis of legal issues. This compendium is provided for general information and educational purposes only. It does not solicit, establish, or continue an attorney-client relationship with any attorney or law firm identified as an author, editor or contributor. The contents should not be construed as legal advice or opinion. While every effort has been made to be accurate, the contents should not be relied upon in any specific factual situation. These materials are not intended to provide legal advice or to cover all laws or regulations that may be applicable to a specific factual situation. If you have matters or questions to be resolved for which legal advice may be indicated, you are encouraged to contact a lawyer authorized to practice law in the state for which you are investigating and/or seeking legal advice.