

Construction Law Update February 2011

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Claim of Unpaid Supplier Given Priority

By: James R. Adams

In a 2-1 panel decision, the Superior Court of Pennsylvania has determined that a supplier of goods to a job site may be able to get payment directly from the owner. *Trevdan Building Supply v. Toll Brothers, Inc.*, Toll Brothers contracted with Houston Drywall for a project in Montgomery County. The drywall contractor financed its expenses through Gulf Coast Bank, which received an assignment of the contractor's rights to receive payment from the owner, Toll Brothers. Contractor Houston Drywall purchased supplies from Trevdan Building Supply. The supplies were provided to the job site, but Houston Drywall went bankrupt before paying the supplier, Trevdan.

Toll Brothers had funds payable to the drywall contractor. The issue was who should get those funds first -- the Bank or the supplier.

The Superior Court ruled that "equitable subrogation" places the claim of the supplier ahead of others to whom the contractor owed money. The unpaid supplier had an equitable lien on the balance which the owner still owed to the contractor, Houston Drywall. The unpaid supplier is to be paid in full from the monies owed by the owner, before general creditors of the contractor such as the Bank.

This is another step on the path started by the General Assembly in 2007, when the Pennsylvania Mechanics' Lien Law was amended to prohibit owners from requiring general contractors and subcontractors to file waivers of the right to have a mechanics' lien on non-residential construction projects -- unless a payment bond is in place.

The Trevdan Building Supply decision may be support for allowing unpaid suppliers as well as subcontractors to recover from the owner/developer, because the supplier has an equitable lien against the monies unpaid and in the hands of the owner. While this goes beyond the holding with Trevdan, it may provide fuel for subcontractors/suppliers to seek payment from the owner.

As the Superior Court decision is based on common law and equitable principles, courts may find such new contract provisions to be unenforceable, but that remains to be seen.

Developers/owners need to exercise caution. It may be wise to require proof from contractors that they have fully paid both Subcontractors and Suppliers and/or adjust their contract terms to address the "equitable lien" theory.

Financing Banks which accept an assignment of a contractor's right to receive payments from the developer, as security for their loan to the contractor, may find themselves holding less security than expected. In the Trevdan case, Gulf Coast Bank had filed a UCC-1, but still was found to be in line for payment after the supplier.

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Update on Mandatory Sprinkler Requirements

By: Maria Di Stravolo Elliott

As many of you know, in December 2009, Pennsylvania adopted the 2009 International Residence Code ("IRC") at Section R313 which mandates that automatic fire sprinklers be installed in new townhouses and in new one- and two-family dwellings. The deadline for compliance for townhomes was January 1, 2010, while the deadline for one- and two-family residences was

January 1, 2011. Many builders have opposed this new mandate and urged legislators for changes. HB 1196, which was introduced in the House back in April 2009 to address the implementation of the sprinkler mandate, was amended by the Senate to provide a one-year extension to the mandatory sprinkler requirements for new one- and two-family dwellings. While the Senate passed the amended bill last October, the House of Representatives was not able to reconvene with sufficient time to have the bill reach the floor for a concurrence vote prior to January 1, 2011. Therefore, the bill is dead and the mandatory sprinkler requirement for one- and two-family dwellings became effective January 1, 2011.

As a reminder, there are two exceptions to the mandatory sprinklers. First, if a design contract or construction contract was signed prior to December 31, 2009, then the 2006 IRC will be in effect and such sprinklers are not required. Second, if an application was submitted for a UCC building permit before January 1, 2011, then the residential construction is not subject to the sprinkler mandate. However, this exception does not apply to townhomes unless the UCC permit was submitted prior to January 2, 2010. In addition, no sprinklers are required for the remodeling or addition of a home unless it already has sprinklers.

The specific requirements for townhouse sprinklers are located in Section P2904 of the IRC, while those for one- and two-family residences can comply with the requirements either in Section P2904 or NFPA standard 13D.

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Employers vs. Independent Contractors: Know the New Law

By: Ronald H. Pollock

On October 13, Governor Rendell signed into law the Construction Workplace Misclassification Act which makes it both a civil and a criminal offense for a contractor to knowingly misclassify an employee as an independent contractor. Pennsylvania joins several states that have taken similar measures to penalize employers that improperly classify workers as independent contractors to avoid paying certain taxes and other employee benefits.

The Act establishes criteria particular to the construction industry under which employees can be classified as independent contractors, including a requirement that the independent contractor maintain liability insurance. The Act also imposes both civil and criminal penalties for misclassification of workers, and requires employers to post notices in the workplace.

Which Employers Are Covered Under the Act?

Employers in the construction industry that are already subject to the Pennsylvania Workers' Compensation Act and the Pennsylvania Unemployment Compensation Act are covered by this new Act. The Act also extends liability to individual officers or agents of the employer. Construction is defined broadly as the "erection, reconstruction demolition, alteration, modification, custom fabrication, building, assembling, site preparation and repair work done on any real property or premises under contract, whether or not the work is for a public body and paid for from public funds."

What Are The Criteria For Independent Contractor Status?

The Act establishes a three-part test that an individual must meet to be properly classified as an independent contractor: 1. The individual must have a written contract to perform construction services; 2. The individual must be free from control or direction over the performance of those services, both under the contract and in fact; and 3. The individual must be customarily engaged in an independently established trade, occupation, profession or business. The Act also sets forth the six specific criteria that will determine whether an individual meets the third part of the test of being "customarily engaged in an independently established trade, occupation, profession or business."

The Act also sets forth the six specific criteria that will determine whether an individual meets the third part of the test of being "customarily engaged in an independently established trade, occupation, profession or business." 1. The individual must possess the essential tools, equipment and other assets necessary to perform the services, independent of the employer. 2. The individual arrangement with the employer is such that the individual must realize a profit or suffer a loss as a result of performing the services. 3. The individual must perform the services through a business in which the individual has a proprietary interest. 4. The individual must maintain a business location separate from the location of the employer. 5. The individual must:

- a. Have previously performed the same or similar services for another person, meeting the criteria 1 through 4 above, and while free from direction or control over the performance of the services; or
- b. Hold him or herself out to others as available and able to perform the same or similar services meeting the criteria of 1 through 4 above, and while free from direction or control over the performance of the services.

6. The individual must maintain liability insurance of at least \$50,000 during the term of the contract.

What Penalties May Be Imposed For Violations Of The Act?

The failure to properly classify an individual subjects employers to civil penalties of up to \$1,000 per misclassified employee for a first violation, and up to \$2,500 per misclassified employee for each subsequent violation. Importantly, the Act also allows the Secretary of Labor and Industry to petition a court for a stop-work order requiring the cessation of work by those individuals who are misclassified, or if a majority of individuals at a worksite are misclassified, to petition for a cessation of all business operations of the employer at each site where a violation

occurred. The stop-work order remains in effect until the court issues a release order.

In addition, the Act provides for criminal penalties for employers that violate the act and those who intentionally contract with such an employer knowing the employer intends to violate the Act. An intentional violation is a misdemeanor of the third degree for a first offense and a misdemeanor of the second degree for a subsequent offense. A negligent violation is a summary offense subject to a fine of not more than \$1,000.

Does The Act Prohibit Retaliation?

Yes, the Act prohibits an employer from discriminating or taking an adverse action against any person who in good faith files a complaint or informs any person about an employer's non-compliance with the Act. An adverse action within 90 days of the person's complaint raises a rebuttable presumption of retaliation.

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Practice Pointer: Choice of Entity

By: Maria Di Stravolo Elliott

If you are considering opening up a new construction business, restructuring or organizing a new venture, you will need to consider the "choice of entity" for your new business. Choice of entity refers to the type of organization your new company will have. Will there be one owner, several related owners or several unrelated owners? Are the owners U.S. citizens? How will the business be managed? Will the business eventually go public? Will the business own or lease real estate? The answers to these questions will lead you to determine which entity best works for you.

In Pennsylvania, there is the choice of sole proprietorship, corporation (C-corporation and S-corporation), limited liability company, general partnership or limited liability partnership. Each entity has different tax and legal liability consequences, and there are different types of organizational documents to be filed with the Department of State. Therefore, it is crucial that you contact an accountant and an attorney before venturing on your own to determine which "choice of entity" best suits your need. We have worked closely with our clients and their accountants to determine the choice of entity for their new businesses. and therefore, we are available to assist you with your legal business needs as you start your new venture.

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