



# Legal Brief

by Timothy J. Woolford, Esquire

## Steps for GCs to limit costs following subcontractor default

*Out-of-business subcontractors can result in surprise liens*

Over the past few years, many general contractors have had to deal with surprise lien and/or payment bond claims. Often, these claims are the result of a subcontractor that has gone out of business before finishing a project. Prior to 2007, a subcontractor that failed to pay its vendors did not often result in a flurry of lien claims because properly filed Stipulations Against Liens usually cut off subcontractors' right to file mechanics' liens. In 2007, the Lien Law was amended and these stipulations were declared invalid on most private projects.

Our firm is often asked by our general contractor clients to provide advice on how to prevent (or at least limit) claims from downstream entities following subcontractor defaults. By far, the best way to limit lien and bond claims by downstream entities is to require, as a condition of receiving payment, that all subcontractors provide partial releases not only for themselves, but also from each of their sub-subcontractors and suppliers. In these partial releases, each sub-subcontractor/supplier releases and waives all lien and/or bond claims

against the general contractor, owner, and surety, up to and including the date of the payment request. Collecting releases from second-tiers will significantly reduce exposure for GCs and their customers. It will also enable the GC to find out early in the process whether the subcontractor is pay-

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ing its bills. Although requiring and collecting releases from second-tier entities is administratively cumbersome, these releases are invaluable. Importantly, unless the contract expressly requires the subcontractor to provide releases from second-

tier entities, withholding payment due to the lack of releases from lower tiers can be a breach of the subcontract. A clause like this in your subcontract will make sure you have the right to demand them:

*As a condition precedent to the payment of any application, Subcontractor shall produce waivers of mechanics lien rights and claim releases in the form attached hereto from Subcontractor and from all persons supplying labor or materials to the Subcontractor through the period covered by the application. The Contractor shall have the right to contact Subcontractor's suppliers and subcontractors of any tier to determine the current status of indebtedness and Subcontractor authorizes them to provide such information. Contractor in its discretion may make checks payable jointly to Subcontractor and the supplier or subcontractor or directly to the supplier or subcontractor for the account of the Subcontractor.*

continued on page 10

# WOOLFORD: Steps to limit costs

continued from page 9


Collecting releases is not a guarantee that claims will not arise unless the GC also knows the identities of the second-tier entities. The subcontract should expressly require each subcontractor to identify all its subcontractors and suppliers. The GC can then be vigilant in obtaining releases from each of the entities identified.

It is important to clearly understand the bond and/or lien rights of lower-tier entities. By understanding the basics of the lien and bond laws, GCs are better equipped to deal with the claims and to avoid paying funds unnecessarily. While this discussion could itself be the subject of an entire article, there are a few important points to understand. On a public project, there is no right to a mechanics' lien because Pennsylvania law prohibits liens on public property. Thus, any attempt by a subcontractor to lien a public property is invalid. On projects where there is a payment bond,

the right to make a bond usually extends no further than the second tier. Thus, only the sub-subcontractors and suppliers who have a contract with the subcontractor have a right to claim on the payment bond. If an entity further downstream than the second tier makes a bond claim, it will be denied because the bond does not protect entities beyond the second tier. The same is true with the mechanics' liens. If there is a right to lien (as there is on most private projects), the right to a lien extends only to the second tier.

Assuming the sub-subcontractor or supplier is a second-tier entity who is entitled to make a claim, the GC should also evaluate whether the claim is timely. For most payment bond claims, written notice of the claim must be provided to the contractor within ninety (90) days of the date that the claimant last performed work or furnished materials. A second-tier entity that missed this deadline has no recourse against the GC, owner or surety. Second-tier entities have

a slightly longer period of time to assert lien rights. Under Pennsylvania law, a mechanic's lien must be filed within six (6) months of the date that the sub-subcontractor/supplier last performed work or furnished materials. Accordingly, when a GC learns that a downstream entity has not been paid, it should determine how far down the contractual chain the potential claimant is and the date that it last performed work. In many cases, this analysis leads to the conclusion that the entity has no lien or bond rights and thus, no recourse against the GC, owner or surety. Its only recourse is a contract action against the subcontractor that hired it.

Every week seems to bring news of another subcontractor closing its doors. This is usually followed by news that sub-subcontractors and suppliers have not been paid for the work they have done. Prudent GCs and others that prime with the owner will have taken these steps to minimize the additional costs that often arise when a subcontractor defaults. 

## Construction spending increases

*Power, Manufacturing, Commercial and Health Care Construction Lead Gains; Contractors Association Officials Call on Congress to Restore Airport Funding, Protect Highways and Transit Construction from Spending Lapse*

**SOURCE:**  
*AGC of America, Press Release*

Construction spending edged up 0.2 percent in June as increases in private non-residential construction outweighed continuing declines in private residential and public construction spending, the Associated General Contractors of America reported today in an analysis of new Census Bureau data. The construction trade association's chief economist, Ken Simonson, predicted further imbalances in spending, with further cuts in public spending likely to offset most or all of the gains in private investment.

"Private nonresidential construction is rebounding, thanks to renewed investments in power, manufacturing, and warehousing

and distribution facilities," Simonson said. "A small rise in homebuilding also helped overall spending rise for the third month in a row, although decreases in multifamily and residential improvements pulled down total private residential construction by 0.3 percent. Meanwhile, public construction shrank 9.6 percent since June 2010, and appears headed down further."

Simonson noted that private nonresidential construction jumped 1.8 percent from May to June and that nine of the 11 categories that the Census Bureau breaks out recorded gains for the month. The largest monthly increases were in manufacturing and power construction, both up 4.0 percent; commercial (retail, warehouse and farm) construction, up 3.1 percent; and health care construction, up 2.3 percent.

Simonson remarked that public construction spending dropped 0.7 percent in June, bringing the total decline since March 2009 to 14.3 percent. The two largest public categories have fallen by double-digit rates over the past year: highway and street construction fell 1.6 percent in June and 10.4 percent year-over-year, while educational construction dropped 4.1 percent for the month and 13.0 percent compared with June 2010 levels.

"Cutting public investments in infrastructure and construction will offset recent gains in private sector activity," said Stephen E. Sandherr, the association's chief executive officer. "Worse, it will put taxpayers on the hook for even greater expenses down the road as infrastructure deteriorates and costly repairs are required."