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Veteran Attorney Joins Firm

Falco A. Muscante has joined Maiello Brungo & Maiello as an associate. Mr. Muscante has nearly 20 years of experience, including eminent domain proceedings and grievance arbitration hearings. Falco earned his Master's and Juris Doctorate degrees from Duquesne University. He joined the Pennsylvania Bar in 1987 and has been admitted to practice before all the Courts of the Commonwealth and federal courts, including the Third Circuit Court of Appeals and the U.S. Supreme Court.

MB&M Hires Attorney Lucas

R. Russell Lucas, Esq., has joined Maiello Brungo & Maiello as an associate. For the firm's construction clients, Russ will apply his extensive background in zoning and municipal law and his experience as Solicitor to a number of the region's zoning hearing boards. Russ is a graduate of Indiana University of Pennsylvania and the University of Pittsburgh School of Law. He joined the Pennsylvania Bar in 1996 and has been admitted to practice before all the Courts of the Commonwealth and federal courts.

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Construction News
2005: Issue 3

Payment/Performance Bonds Are
Required Reading

Case Study: Sub Collects \$300K

Legislative Updates

Succession Plan Options

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DON'T FORGET THE BOND

Bonds are issued to protect parties in a project when someone does not carry out his responsibility – either to perform or make payments. In all public projects (state, local, and federal) in excess of certain dollar amounts, the prime contractors are required to provide Performance Bonds and Payment Bonds. The prime contractors are those with a direct contract with the public entity.

Performance Bond

The Performance Bond protects the owner of the project, which, in a public project, is the public entity. A Performance Bond provides a guarantee that the prime contractor will perform as stated in the contract and, if not, the owner may look to the surety (the company issuing the bond) for payment.

Payment Bond

The Payment Bond protects:

- Subcontractors who contract directly with the prime contractor (first-tier claimants)
- Material suppliers who have a contract directly with the prime (first-tier claimants)
- Suppliers to subcontractors of the prime contractor (second-tier claimants)
- Sub-subcontractors to subcontractors of the prime (second-tier claimants)

If your company falls into at least one of these categories, it would be wise to obtain a copy of the Payment Bond early in the job, before any payment issues arise. This document explains your rights to collect payment from the surety in the event that the contractor (or subcontractor) does not make payment as agreed.

Time Limit to Claims

In the event that a prime contractor fails to make payments on its contract with a subcontractor or a purchase order with a supplier, the subcontractor or supplier may make a claim on the Payment Bond.

Timing is important. In order to preserve a claim, these entities must bring suit on the bond within one year after the last date that material or work was performed on the bonded project. And, while one year is the statutory limit, some bonds provide for a longer period.

If your company is a second-tier claimant; i.e., a sub-subcontractor or a material supplier to a subcontractor of the prime contractor, the timing is much tighter. In order to preserve your right to make a claim on the bond, you must provide notice within 90 days of the last material or work performed on the bonded project.

The notice generally must be sent to three parties: the owner, the prime contractor, and the entity that has not paid. Again, the terms written in the bond may alter these notice provisions – you need to review it before any claims arise.

If You Still Aren't Paid...

Once a claim is made to the bonding company (surety), payment is not always automatic. The surety is entitled to bring up the same defenses that its principal (the entity) could assert if a claim had been brought directly against the entity. For example, if the claimant on the bond is a subcontractor to the prime contractor, the surety could assert a set-off for defective work performed by the subcontractor or a

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Don't Forget the Bond, continued...

set-off for work not completed.

It's up to you how aggressively you want to pursue payment. However, if the claim remains unpaid, again, in order to preserve the claim, suit must be brought within one year and 90 days after the last material or work was performed on the bonded project.

The bottom line is that a Payment Bond is not a sure-fire means of getting payment from a stubborn party; to make it work, a claimant must be diligent in preserving his rights.

Recent Win: DelRay Windows v. Mars Builders Inc.

The client, a commercial window installer, was pursuing payment of \$263,000 from the builder/owner. The client's claim was that installment payments had stopped, although the job was 90 percent completed. In addition, the client was forced off the job because he could no longer fund the operation. MB&M filed an action on behalf of the client with the American Arbitration Association to recoup the contract balance, penalties, interest and attorney fees. The builder/owner filed a counterclaim with the AAA alleging various concerns about the materials and workmanship.

MB&M attorneys gathered information, including from the former construction manager, who had left the site before the window installer began work.

Upon review, MB&M attorneys found there was no documentation of any purported quality disputes; that shop drawings did not specify make or manner; and there was no construction manager on site to provide guidance to the client. In addition, MB&M called in an expert to provide testimony disputing the counterclaims of improper installation, and also cross-examined the builder/owner's expert.

The result was a judgment in favor of the client/plaintiff of \$386,880.

Best Value Contracting

In July, the Pennsylvania DGS released a two-page "clarification" of the Best Value Contracting RFP process. If you haven't yet done so, you can read it at www.dgs.state.pa.us/dgs/cwp.

Legislation Passed

Greater School Construction Reimbursement – Act 46

For the first time since 1987, the state has increased construction reimbursements to school districts. Act 46, approved by the Governor on July 13, 2005, includes additional reimbursement for construction projects – if they use a pre-approved design from the Department of Education's school design clearinghouse or meet certain environmental design standards.

Legislation in Session

Sales Tax Exclusion – HB 1873

If passed, this bill would amend the Tax Reform Code to give an exemption from sales and use tax to construction contractors employed by a nonprofit or school.

Building Code Exemptions – HB 1507

This proposed amendment to the Pennsylvania Construction Code Act would provide that existing buildings without a certificate of occupancy prior to April 10, 2004, would be treated as an existing building under Chapter 3. These buildings would be issued an occupancy permit if the entire building meets the requirements for fire protection and egress; and the building is not unsafe, unsanitary, a fire hazard, or dangerous to human life or public welfare.

Mechanic's Lien Law – HB 1637

This bill proposes to amend the Mechanic's Lien Law so that only a contractor – and not a subcontractor – may waive lien rights.

Electronic Bidding – SB 62

This proposed amendment to the Procurement Code would require the Department of General Services to review, assess, and respond to Commonwealth purchase proposals for supplies, services, or construction. The proposed legislation also adds a chapter on "Local Government Unit Electronic Bidding Act." This would permit local government units to accept electronic submission of bids if the local government has the capability to maintain bid confidentiality until opening time.

Competitive Bidding – Various House Bills

Various bills have been introduced to increase the minimum threshold amount of work that would require public notice. For example, the First Class Township Code, Municipal Code, School Code, and County Code thresholds would be raised from \$10,000 to \$25,000.

SUCCESSION PLANNING I: MANAGEMENT BUYOUT

While most of us don't like to admit it, the day will come when an owner has to think about letting go of the company. According to a recent industry survey, 67% of all contractors surveyed do not have an exit strategy.[†] This article begins a series that will cut this complex decision down to size.

The first thing to understand about planning your business succession is that many factors affect your strategy, so planning must begin well before your desired exit date.

The second thing to know is that there are four basic options:

- Turnover to Family Members
- Sale to an Outsider
- Liquidation
- Sale to Key Employees

When You Sell to Key Employees

A phased-in buyout by key employees, sometimes referred to as a management buyout, is an attractive option. It keeps the business independent and ensures that it will continue operating. A management buyout can take a variety of forms; the most common utilize buy-sell agreements and stock options. Basically, you sell shares to those employees you wish to see running the company after your exit.

It enables you to set the date. You can arrange for key employees to obtain ownership over a number of years prior to a final buy-out.

Key employees become stakeholders in the business. This, in turn, increases loyalty, reduces turnover, and allows you to increase their responsibility. In addition, employees obtaining ownership should be expected to sign a Buy-Sell Agreement that contains non-compete, confidentiality, and other such provisions. The agreement also may provide for the ultimate buyout of the company by the key employees over time or in the event of your untimely death.

You maintain an income. As you phase in ownership, you can maintain your compensation, even as you allow other managers to take on some of your responsibilities.

It gives you control. The Buy-Sell Agreement provides you the opportunity to repurchase ownership, in the event that a key employee leaves the company or is terminated. It also enables you to specify the repurchase price as you see fit – discounted or otherwise.

Buyout Success Factors

If the management buyout option interests you, the basic success factors are:

- Identify your anticipated exit date.
- Identify key employees as future purchasers.
- Implement greater employee responsibility before your exit.
- Use stock ownership to foster key employee loyalty and establish confidentiality and non-compete provisions.

How Employees Pay for Ownership

The flexibility in financing the sale is another attractive feature. Multiple options exist, including traditional bank financing, owner financing, and employee stock ownership plans (ESOPs). Each of these options will be explored in upcoming *Construction Updates*, or you can contact any of our Construction Group attorneys to discuss your individual situation.

IRS Changes Mileage Deduction

A mid-year change could help save on your federal taxes.

See "Hot Topics,"
at www.mbm-law.net.

[†] Second annual Intuit Construction Business Solutions industry survey.