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Message from the Editor-in-Chief…

Winds of Change

It appears that a lot of change is in the air. Aside from the customary changing of seasons, there are a number of other changes which will affect us all in the upcoming months, years and possibly beyond. Certainly, change has been felt in Washington, D.C., where control of Congress has changed hands for the first time in more than a decade. A bit closer and more direct to the industry, there have been a number of changes even since the publication of the last issue of *The Critical Path*. These changes include new tax incentives for Green Buildings (addressed in an article by Ruth Holzman), the ever-changing landscape of claims against sureties for alleged bad faith (addressed in an article by Jim Doerfler), and the first substantive change to Pennsylvania's Mechanics' Lien Law in more than 43 years. As with most changes, the first step in embracing them is to be aware of them and to appreciate how they may impact your business and project management. In this regard, we trust that this issue will help to highlight some of those important changes and address that first-needed step.

Edward B. Gentilcore, Esquire
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New Tax Incentives for "Green" Buildings Have Owners Seeing Green

Section 179D [of the Internal Revenue Code] gives owners of commercial real property a tax break by allowing them to deduct the cost of certain energy-efficient property placed in service in 2006 and 2007. The new law applies to both new construction and retrofits of existing construction.

In light of the growing interest in "green," energy-efficient buildings for a variety of economic, environmental and social awareness reasons, commercial building owners may want to take a look at Section 179D of the Internal Revenue Code.[1] This new Section is the first direct monetary incentive offered by the federal government to encourage the use of energy-efficient property in the construction of new, as well as in the renovation of older, commercial structures.

Section 179D gives owners of commercial real property a tax break by allowing them to deduct the cost of certain energy-efficient property placed in service in 2006 and 2007. The new law applies to both new construction and retrofits of existing construction.

Although Section 179D was enacted last year as part of the Energy Policy Act of 2005, until recently real property owners had been unable to take advantage of the |tax break because of a lack of IRS guidance. In June 2006, the IRS issued Notice 2006-52, which establishes a process to certify the required energy savings in order to claim the deduction. With the tax break scheduled to expire/sunset at the end of 2007, building owners need to act quickly if they wish to qualify for the deduction.

Section 179D Basics

Ordinarily, the owner of commercial real property must capitalize the cost of the property, including the cost of any improvements or retrofits. The costs are then depreciated under the straight-line method over the MACRS class life for the property, which for commercial buildings is 39 years. New Section 179D allows an owner to *deduct* rather than capitalize certain costs of energy-efficient commercial building property.

"Energy-efficient commercial building property" is defined as depreciable property that: (1) is installed on or in any building located in the United States; (2) is within the scope of Standard 90.1-2001; (3) is installed as part of either (a) the interior lighting systems, (b) the heating, cooling, ventilation and hot water (HVAC) systems or (c) the envelope of the building[2]; and (4) is certified as being installed as part of a plan designed to meet certain energy-saving targets.

"Standard 90.1-2001" refers to Standard 90.1-2001 (as it existed on April 2, 2003) of the American Society of Heating and Refrigerating and Air Conditioning Engineers ("ASHRAE") and the Illuminating Engineering Society of North America ("IESNA"). Known as the "FASB of building design and energy standards,"[3] ASHRAE, which is composed of professional engineering groups, sets standards for energy efficiency and product design for the heating, cooling, and lighting systems of buildings.

A building meets the energy-saving targets if the property is installed pursuant to a plan to *reduce total annual energy and power costs of the building's interior lighting and HVAC systems by 50 percent or more* in comparison to a hypothetical reference building that meets the minimum requirements of Standard 90.1-2001. It should be noted that the 50 percent reduction refers to a reduction in energy and power *costs*

to the commercial building owner, rather than a reduction in actual units of energy consumed. The 50 percent reduction must be achieved solely through energy and power cost reductions for the interior lighting and HVAC systems. Reductions in other energy uses (such as receptacles, process loads, refrigeration, cooking and elevators) may not be taken into account.

It should also be noted that the methods for calculating energy and power costs must be fuel-neutral. The energy-efficiency measures must not discriminate between fuel sources. A building is eligible for the deduction regardless of whether it uses a gas or oil furnace or boiler, an electric heat pump, or another fuel source.

Amount Deductible

The amount deductible is the lesser of (1) the cost of the energy-efficient commercial building property, or (2) the product of $1.80 multiplied by the square footage of the building. Congress recognized that the actual cost of energy-efficient commercial building property necessary to achieve the energy-saving targets would likely exceed the $1.80 per square foot limitation.[4] It was hoped that the combination of the tax deduction and future savings on energy costs would make the investment financially attractive to real property owners.

In addition, Section 179D(g) requires the IRS to issue regulations that provide for the recapture of the deduction if any certified energy savings plan is not fully implemented.

Notice 2006-52

As noted above, Section 179D was not viewed as an incentive to commercial building owners to incur the cost of designing and installing more energy-efficient building subsystems because of the lack of IRS guidance on Section 179D. Notice 2006-52, issued on June 26, 2006, sets forth interim guidance until the IRS issues regulations on Section 179D. According to the Notice, the procedures described in the Notice are expected to be incorporated in forthcoming regulations.

The Notice prescribes the content of the certification necessary in order to claim the tax deduction, and the qualifications that must be met by the person providing the certification.

In addition, the Notice provides that buildings below the 50 percent energy reduction threshold may qualify for a deduction of up to 60 cents per square foot if they meet a 16-2/3 percent energy savings target in any one of the three building subsystems (i.e., interior lighting systems, HVAC or building envelope). This partial deduction was aimed at owners of commercial lease properties. Historically, such owners have avoided improving outdated systems because of the significant capital investment required and because their utility costs are typically passed along to tenants. It is hoped that the partial deduction will be an incentive for owners to revisit their earlier analyses on this subject and to invest in energy-efficient systems.

The Notice also contains a special interim rule for the partial deduction as it applies to interior lighting systems. Under this rule, the system-specific energy savings target for a lighting system is deemed to be met by a reduction in lighting power density ("LPD") rather than a reduction in energy and power costs.

Also included in the Notice is the announcement that the Department of Energy will create and maintain a public list of software that must be used to calculate energy savings for purposes of providing the certification.[5] In turn, the Notice sets forth a procedure that software developers must use if they desire to have their software included on this list.

Section 179D does not require that the energy-efficient commercial building property be directly responsible for the reduction in energy and power costs, but only that it be "installed as part of a plan to reduce the total annual energy and power costs…" In addition to the actual property to be installed, a plan may include other features designed to reduce power costs such as a reduction in peak electricity usage or negotiated power discounts. It is unclear whether the approved software will permit these other features to be taken into account in calculating energy savings, or whether the software will base the calculations solely on the energy savings attributable to the actual qualifying property placed in service.

Some Immediate Observations

Early Sunset Date. One problem with this new tax deduction is the limited time that it will be available. It is only available for energy-efficient commercial building property placed in service before Jan. 1, 2008. The 50 percent whole building energy reduction goal is achievable for new construction, but only with significant planning and investment. It may be difficult to design, construct and complete a building that meets

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the 50 percent whole building energy reduction target within this time period. Although numerous bills were introduced this year to extend the sunset date to as late as 2014,[6] Congress has yet to act on any of them. In the meantime, property owners may not find sufficient incentive to invest in or accelerate any designs for projects that as currently scheduled cannot be placed in service by the Dec. 31, 2007 deadline.

Publicly Owned Buildings. Another problem is the IRS' failure to issue guidance on the availability of the Section 179D deduction for energy-efficient property installed in a building owned by a federal, state or local government. Although the statute requires the Secretary of the Treasury to issue regulations to allow the deduction "to the person primarily responsible for designing the property in lieu of the owner of such property,"[7] no such guidance is contained in Notice 2006-52. This is unfortunate, as the public sector may be the player most interested in getting off the side-lines and actually getting into the "green" building game.

Partial Deduction May Be More Attractive. A commercial building owner may find the partial deduction (60 cents per square foot if the building meets a 16-2/3 percent energy savings target in any one of the three building subsystems) more attractive for several reasons. Such a smaller-scale project is more likely to be completed by the Dec. 31, 2007 deadline. In addition, a building owner has more flexibility when only one of the three building subsystems has to be designed and constructed to achieve the requisite energy savings targets.

Consider the Partial Deduction for Lighting Systems. Among the three building subsystems, lighting systems are the most feasible, especially for retrofits of existing commercial buildings. Access to a building's lighting system is usually relatively easy and there are known technologies, capable of present cost estimation, available to meet the LPD reduction requirements.

Conclusion

With Section 179D and Notice 2006-52, the federal government has taken a big first step in encouraging "green" building development. However, in order to maximize the intended benefits, changes, clarifications and further guidance will be necessary for the Section to realize its full potential.

Ruth N. Holzman, Esquire
Century City Office

Post-Script
The Tax Relief and Health Care Act of 2006 (H.R. 6111), which was passed by the 109th Congress in its final hours in December 2006, extended the sunset date of Section 179D for one year. The tax deduction is now available for energy-efficient commercial building property placed in service before Jan. 1, 2009.

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1 All section references are to the Internal Revenue Code of 1986, as amended (the "Code").

2 The U.S. Department of Energy defines a building envelope to include "everything that separates the interior of a building from the outdoor environment, including the windows, walls, foundation, basement slab, ceiling, roof system and insulation."

3 Joseph M. Mikrut, "New Energy Efficiency Deduction Offers Commercial Building Owners Opportunities," *BNA Tax Management* No. 169 (Aug. 31, 2006).

4 The bill that originally passed the Senate had a $2.25 per square foot limitation. It was reduced to $1.80 per square foot in conference. In 2006, numerous bills have been introduced in Congress to increase the limitation to the original $2.25 per square foot, as well as to extend the sunset date for the Section.

5 According to the Notice, this public list will appear at http://www.eere.energy.gov/buildings/info/tax_credit_2006.html. The Department of Energy's website also contains FAQs about Section 179D; see "An Overview of Section 1331 of H.R. 6, the Energy Policy Act of 2005 (Public Law 109-58), posted at http://www.efficientbuildings.org/about_the_provision.html#6.

6 In addition, and as noted above, some of these bills would also increase the $1.80 per square foot limitation to $2.25 per square foot.

7 Section 179D(d)(4).

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Legislative Update–Pennsylvania Substantively Amends Its Mechanics' Lien Law of 1963 for the First Time in 43 Years

Perhaps because the last time Pennsylvania substantially revised its Lien Law statute before 1963 was in the early 1900s, observers of Pennsylvania's Mechanics' Lien Law, 49 P.S. §1101-1902 (the "Lien Law"), believed that almost an equal amount of time would have to pass before further substantive amendments were made. However, because of the increasing pressures of project economics, and the impacts of project failures on contractors, subcontractors, suppliers (and in some instances, lenders), the Lien Law was successfully amended in a substantive way for the first time in 43 years when Pennsylvania's Gov. Rendell signed House Bill 1637 into law June 29, 2006 (the "Amendments"). These Amendments dramatically alter the landscape for Mechanics' Lien Claims on or after the effective date of the Amendments, Jan. 1, 2007.

The first notable change is the modification of two definitions in the statute. The first of these definitions is for a "residential building." The second definitional change modifies the existing definition of subcontractor to include not only first-tier subcontractors and suppliers (previously covered by the Lien Law), but also second-tier subcontractors and suppliers to first-tier subcontractors.

This second modification will produce dramatic impacts in the Commonwealth. This is because a multitude of new claimants and potential claimants have just been added to the exposure roster evaluated by owners and contractors alike during the course of the project, and during project closeout.

Despite the dramatic effect of that change, the biggest change is the almost wholesale invalidation of upfront waivers of mechanics' lien claims, which waivers have been a feature of Pennsylvania's mechanics' lien lexicon for roughly 100 years. For non-residential building projects and for residential building projects in excess of $1 million, where the contracts are executed on or after Jan. 1, 2007, upfront waivers of mechanics' liens by "contractors" shall be deemed void as against public policy. Upfront waivers of lien by contractors remain available for residential projects less than the $1 million threshold.

As for subcontractors, the same general restrictions on upfront waivers of mechanics' liens apply. However, with regard to subcontractors, upfront waivers of lien can be obtained on non-residential projects and residential projects in excess of $1 million when a labor and material payment bond has been posted by the contractor "guaranteeing payment for labor and materials provided by subcontractors." Of course, for residential projects less than $1 million, the existing upfront waiver structure can be followed and life will go on *mostly* unchanged.

For most other projects in Pennsylvania, the significantly curtailed upfront waiver of lien process will give rise to partial waivers of lien in exchange for payment procedure that occurs on many projects in many other states and jurisdictions outside of Pennsylvania. These partial waivers should be exchanged as a part of the payment process, and steps need to be taken to accommodate this new procedure for future Pennsylvania construction projects.

A further specific modification relating to subcontractors is the elimination of a preliminary notice that subcontractors on alteration and repair projects were required to send before they left the jobsite. Now, prior to filing a Mechanics' Lien Claim, all subcontractors must only give a Notice of Intention to file the Mechanics' Lien Claim at least 30 days in advance of the Mechanics' Lien Claim filing.

Another important modification to the Lien Law is the extension of time for filing the Mechanics' Lien Claim itself. Prior to the Amendments, the lien claim would have to be filed within four months of the date that claimant last performed labor or supplied materials to the project. Now, that date has been extended by a period of two months.

The last of the Amendments with more substantive significance will affect the rights and recourse of certain lenders on a construction project. Under the Lien Law prior to the Amendments, there were significant risks that on certain types of projects, the lenders' security interests could have been held to be inferior to the potential lien claimant, depending upon when

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…because of the increasing pressures of project economics, and the impacts of project failures on contractors, subcontractors, suppliers (and in some instances, lenders), [Pennsylvania's] Lien Law was successfully amended in a substantive way for the first time in 43 years when Pennsylvania's Gov. Rendell signed House Bill 1637 into law June 29, 2006 (the "Amendments"). These Amendments dramatically alter the landscape for Mechanics' Lien Claims on or after the effective date of the Amendments, Jan. 1, 2007.

work began on the project site relative to the recording of the lender's mortgage instruments. With the Amendments, many of those issues will cease to exist insofar as a super-priority-type of advantage is given to certain types of lenders, namely those providing purchase money mortgages and open-end mortgages. Both of these mortgages are specifically identified in the context and body of the Amendments, and both are also governed by other statutory provisions in the state.

While these changes are significant on their face, their impacts may become far more drastic and complicated when these provisions are considered in the context of other statutory provisions on the books in Pennsylvania, and the case law interpreting the pre-Amendments provisions that have not been *directly* modified by the Amendments. Like all other statutory enactments, time will certainly tell how these provisions are embraced and interpreted by the courts. In the meantime, based on the clear language of the Amendments themselves, the approach and attitude towards mechanics' lien claims in Pennsylvania will most certainly change following the drop of the ball at Times Square on Dec. 31, 2006 at 11:59 p.m.

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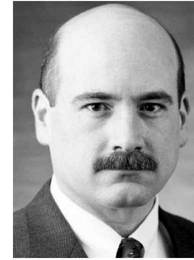

Editor's Note: Edward B. Gentilcore, a partner in the Pittsburgh office, has a practice which places heavy emphasis on construction litigation. He has represented owners, contractors, subcontractors and material suppliers in matters involving a variety of construction-related issues, including design-build, delays, extras, contract negotiation and compliance, construction safety, payment, and mechanics' liens. He has prepared and negotiated numerous agreements for a wide variety of private, public, commercial and industrial projects. Ed's concentration in construction litigation, as well as in design and construction contracts, has enabled him to serve on the Construction Litigation Committee of the ABA Section of Litigation, where he is currently Committee Liaison, and he frequently contributes articles on various construction-related topics.

Surety Bad Faith, Part II: A Fresh Look at the Continuing Debate Over Whether Sureties Should Be Considered "Insurers" for Purposes of Insurance Bad Faith Statutes–The Sureties Strike Back

In Part I of this article, published in the Spring 2006 edition of *The Critical Path*, we looked at how courts initially treated the contentious question of whether sureties should be treated like insurers for purposes of bad faith statutes and claims. Those initial decisions generally tended to equate sureties to insurers for purposes of bad faith claims. When the American Bar Association's Tort and Insurance Practice Group published its Second Edition of *The Law of Suretyship* treatise in 2000, the authors of a chapter on "Extra-Contractual Damages" noted that a majority of the states recognized a common law cause of action for bad faith against sureties, but predicted that "the tide appears to be turning as more states address this issue and hold that sureties should not be liable for common law bad faith."[1] This second part of the article explores how the surety companies responded to the initial volley of bad faith case law by emphasizing the inherent differences between suretyship contracts and insurance contracts, and the risks covered. In particular, this article explores how, in key jurisdictions such as California, Texas and Pennsylvania, sureties have successfully been able to get courts to reconsider the notion of whether sureties should be treated the same as liability insurers for state bad faith law purposes, and have registered some successes. This article also tries to provide some guidance for owners and contractors unsure of how to respond to this changing landscape regarding bad faith case law.

The Sureties' Defense to Bad Faith Claims: The Inherent Differences Between Suretyship and Insurance

The sureties responded to the initial volley of lawsuits by developing a legal approach based on emphasizing the inherent *differences* between suretyship and insurance contracts. The identified differences have included the following: a surety bond is a financial credit product, not an insurance (indemnity) product; the tripartite contractual relationship of the surety, causing the surety to balance these interests when responding to claims; the surety bond form customarily is written or furnished by the obligee rather than the surety; the surety is requested to assure performance of construction contracts that are entered into by parties with commercial sophistication, relative parity of bargaining power, and access to ample legal and technical advice; the bond premium usually is paid by the contractor to the surety out of the contract price, rather than directly by the obligee to the surety, and the pricing of the premium by the surety is not based upon the risk of loss, but on the financial condition of the bonded contractor.[2] These arguments have increasingly been accepted by courts in major jurisdictions.

The Texas Courts Draw the Line Against Bad Faith Claims

Sureties seeking to avoid liability on a bad faith basis have often had to confront or overcome arguments that the inclusion of "surety" within the definition of "insurer" in many state insurance codes suggests that a surety should be viewed as an insurer for bad faith purposes. Nevertheless, sureties have often been able to overcome these definitional hurdles.

Several prominent courts have found unpersuasive the argument that, because a surety is listed in the insurance code, it should be treated the same as an insurer. For example, the Texas Supreme Court in *Great American Insurance Company. v. North Austin Municipal. Utility Dist. No. 1*[3] rejected efforts to tag sureties with bad faith liability on a definitional basis, noting that the Texas Legislature did not intend to include suretyship as the "business of insurance" for all purposes under the Texas Insurance Code.[4] Rather, the differences between a surety bond and a traditional insurance contract, and the underlying policy considerations, were identified as the criteria that should determine whether bad faith liability for sureties is appropriate. In that case, the court held sureties should not be held to the same standards as insurers.

California Sides with the Sureties

Several years later, the California Supreme Court adopted a similar approach. The court addressed the issue in *Cates Construction, Inc. v. Talbot Partners*[5] and concluded that "the mere inclusion of surety arrangements in the Insurance Code should not be determinative" and discussed the various differences between suretyship and insurance policies.[6] Having set

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forth this legal framework, the *Cates* court concluded that tort recovery was not appropriate for an alleged breach of an implied covenant of good faith and fair dealing in the context of a construction performance bond because (1) such a bond is not an insurance policy; (2) extra-contractual remedies are unnecessary in the interests of social policy; (3) obligees have ample power to protect their interests through negotiation; and (4) sureties are deterred from acting unreasonably by statutory and administrative sanctions.[7] While the court acknowledged that other jurisdictions have concluded to the contrary, it found that those cases failed to give appropriate consideration to the material differences between insurance policies and performance bonds, and placed undue emphasis on statutes that regulate suretyship as a class of insurance.[8] In reaching this decision, the California Supreme Court expressly disapproved of the reasoning of an earlier California Court of Appeals decision in *Mammoth Vista* suggesting that sureties could be subjected to bad faith liability.[9]

The Texas Supreme Court in *Great American* likewise found no duty of good faith and fair dealing between a surety and an obligee, emphasizing that commercially sophisticated parties of relatively equal bargaining power were involved, and noting the conflicting obligations in the tripartite relationship between a surety, its principal, and the bond obligee, pointing out that the obligation of a surety to a bond obligee is secondary to the obligation owed by its principal.[10] This analytical approach advocated in *Cates* and *Great American* has also attracted a number of adherents in different jurisdictions throughout the country.[11]

The Pennsylvania Courts Follow the Trend

Although there are no reported Pennsylvania Superior Court or Supreme Court decisions on the issue of surety bad faith, the courts in Pennsylvania have tended to follow the progression in legal analysis reflected in the decisions issued by the California courts. The initial sets of opinions issued by courts in Pennsylvania assumed, without any real analysis on the issue, that bad faith claims could be asserted against sureties based simply on a definitional approach to the issue that viewed sureties as insurers.[12] As later courts were called upon to address directly the defenses asserted by the sureties, they focused on the functional differences between insurance contracts and suretyship agreements and the interests served by each. Currently, the four federal district court decisions,[13] and the three Pennsylvania Common Pleas Court decisions (including those by courts sitting in Pittsburgh and Philadelphia)[14] that have directly confronted the issue have all declined to recognize a bad faith claim brought by an obligee against a surety issuing a performance or payment bond.

But, Disagreements Persist: Other Courts Reject the Suretyship Distinction and Continue to Hold Sureties Accountable for Bad Faith Conduct

Although many of the initial decisions permitting bad faith claims against sureties were rendered in the 1980s and early 1990s, several more recent court opinions continue to apply bad faith liability and respond to the approaches taken by other courts that attempt to draw a distinction between suretyship contracts and insurance contracts. For example, in 1997, the Colorado Supreme Court in *Transamerica Premier Insurance Company v. Brighton School District 27J*,[15] determined that it was proper to permit a school district to assert a bad faith claim against a performance bond surety based on the reasoning that "[a] special relationship exists between a commercial surety and an obligee that is nearly identical to that involving an insurer and an insured."[16] In support of this conclusion, the court observed that, when an obligee requests that a principal obtain a surety bond, it is essentially insuring itself from the potentially catastrophic losses that would result in the principal defaulted on its contractual obligations.[17] Thus, although acknowledging certain differences between suretyship contracts and insurance contracts, the court nonetheless determined there was a sufficient parallel in the underlying interests to be protected so that imposing bad faith liability was appropriate. Four years later in 2001, and after performing a nationwide survey of the case law on both sides of the issue, the Delaware Superior Court in *International Fidelity Insurance Company v. Delmarva Systems Corporation* agreed with the Colorado Supreme Court's assessment of the issues in *Transamerica* and likewise held sureties should be subject to bad faith claims under Delaware law.[18] A few

months earlier, the U.S. District Court for the District of New Jersey predicted that the New Jersey Supreme Court would reach a similar conclusion and permit bad faith claims against sureties under New Jersey law.[19]

Conclusion

While the courts in Pennsylvania appear to have developed a consensus on whether sureties should be subject to bad faith liability claims since this issue was last addressed, the question more broadly appears likely to remain an unresolved one as courts throughout the country continue to struggle with the issue and continue to reach different decisions. Given the different interpretations attached to the relative similarities and differences between insurance and surety contracts, and the underlying policy interests to be served, the only definite advice that an owner or subcontractor considering asserting such bad faith claims can rely upon is the need to carefully review the relevant case law in the particular jurisdiction to see which of these two approaches is more likely to be followed.

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[1] *Id.*

[2] *See* Philip L. Bruner & Patrick J. O'Connor, 4 "Bruner and O'Connor on Construction Law," § 12:7 *Suretyship and "bad faith"* (2005).

[3] *Great American Ins. Co. v. North Austin Mun. Utility Dist. No. 1*, 908 S.W.2d 415, 418-20 (Tex. 1995).

[4] *Id.*, 908 S.W.2d at 420.

[5] *Cates Construction, Inc. v. Talbot Partners*, 21 Cal. 4th 28, 980 P.2d 407, 86 Cal. Rptr. 2d 855 (Cal. 1999).

[6] *Id.*, 980 P.2d at 418-422.

[7] *Id.*, 980 P.2d at 427.

[8] *Id.*

[9] *Id.* at 417.

[10] *Great American*, 908 S.W.2d at 418.

[11] *See, e.g., Great American Ins. Co. v. General Builders, Inc.*, 934 P.2d 257 (Nev. 1997); *Republic Ins. Co. v. Board of County Com'rs of St. Mary's County*, 511 A.2d 1136 (Md. App. Ct. 1986) (surety's liability limited to penal sum of bond); *Barr/Nelson, Inc. v. Tonto's, Inc.*, 336 N.W.2d 46 (Minn. 1983) (surety liable only for contract damages even in face of "intentional" breach of bond); *Bell BCI Co. v. HRGM Corp.*, 276 F.Supp.2d 462 (D. Md. 2003).

[12] *See, e.g., Turner Const. Co. v. First Indem. of Am. Ins. Co.*, 829 F. Supp. 752 (E.D.Pa. 1993) (noting that Section 1171.3 of Pennsylvania's Unfair Insurance Practices Act defines "insurance contract" to include any contracts of suretyship); *Nazarewycz v. Plumb-Town, Inc.*, Civ. No. 94-3828, 1995 WL 549052, 1995 U.S. Dist. Lexis 13455 (E.D.Pa. 1995) (suggesting indirectly that bad faith claims pursuant to the Pennsylvania Bad Faith Statute 42 Pa. C.S. § 8371 could be asserted against a surety).

[13] *See Norwood Co. v. RLI Ins. Co.*, 2002 U.S. Dist. Lexis 5560, 2002 WL 485694 (E.D.Pa. Apr. 1, 2002); *Superior Precast, Inc. v. Safeco Ins. Co. of Am.*, 71 F.Supp.2d 438 (E.D.Pa. 1999); *Allegheny Valley Joint Sewage Auth. v. American Ins. Co.*, Civ. No. 94-2105, 1995 U.S. Dist. Lexis 22091 (W.D.Pa. Aug. 17, 1995); *Pullman Power Prods. v. Fidelity and Guaranty Ins. Co.*, Civ. No. 96-636, 1997 U.S. Dist. Lexis 23554 (W.D.Pa. Feb. 21, 1997).

[14] *See Collier Dev. Co., Inc. v. Jeffco Const. Co.*, 25 Pa. D.&C. 4th 193 (Pa. Comm. Pl. Ct., Allegheny Cty. 1995); *M.A. Bruder & Sons Inc. v. Williams*, 47 Pa. D.&C.4th 243 (Pa. Comm. Pl. Ct., Monroe Cty. 2000); *Ferrick Constr. Co. v. One Beacon Ins. Co.*, No. 3858 Apr. Term 2004, 2004 WL 3051443 (Pa. Comm. Pl. Ct., Philadelphia Cty. Dec. 27, 2004).

[15] *Transamerica Premier Ins. Co. v. Brighton Sch. Dist.* 27J, 940 P.2d 348 (Colo. 1997)

[16] 940 P.2d at 353-354.

[17] 940 P.2d at 352.

[18] *International Fidelity Ins. Co. v. Delmarva Sys. Corp.*, No. 99C-10-065 WCC, 2001 WL 541469 (Del. Super. Ct. May 9, 2001).

[19] *See United States ex. rel. Don Siegel Constr. Co., Inc. v. Atul Constr. Co.*, 85 F.Supp.2d 414 (D. N.J. 2000).

Editor's Note: James M. Doerfler, who joined Reed Smith in 1998, focuses his practice on general commercial litigation, construction litigation and construction contract drafting, and insurance coverage matters related to construction projects. A partner in the Pittsburgh office, he has also been involved in private and public commercial construction projects with subcontractors, general contractors, corporations and institutions, commercial contract disputes and securities-related litigation. Representative cases in the construction sector have involved construction payment, and defect and/or delay claims involving school buildings, power plants, steel mills, pharmaceutical plants, wastewater treatment facilities, courthouses and commercial office buildings. Prior to Reed Smith, Jim worked in the local construction industry with a commercial electrical contractor. He served as project manager, estimator and corporate secretary, and his responsibilities included overseeing numerous commercial construction projects in which the company served as subcontractors to general contractors or worked for corporate and institutional organizations directly.

As BUILT...

The Closer: Bringing Your Project to a Conclusion

In short, in order to truly achieve success on a given construction project, the finish line cannot always be perceived as the completion of design and construction activities itself. While having the new building available for occupancy, or having the trailer demobilized from the job site may signal a milestone worthy of pride, further pride will be felt when the project can be concluded at both the physical and the documentary level.

Although baseball is, for the most part, heading into its obligatory winter's hibernation, memories of the recent season and the post-season championships still remain relatively fresh. In particular, a great deal of emphasis during the regular season and during the play-offs focused on the role of the closer, a pitcher who, while for most of the game is more a spectator than participant, is nevertheless called upon to get the last crucial strikes and/or outs to end the game and secure victory for his team. Indeed, so much emphasis of late has been placed upon the closer, that a whole new realm of statistics has been developed to address that person's specialty. One significant measure applied to the closer is the number of wins that are *not* secured as a result of his failure to bring the game to an end, referred to as the "blown" save.

In the construction industry, it has been remarked that anyone can begin a project, most can continue a project, many can survive a project, few can consistently and successfully deliver unchallenged results, but that it takes a true artist and effort to close a given project completely. However, it is the success in efficiently and effectively closing out these projects which can, at times, define and write the final chapter of the project and characterize it as either a success or a "blown" save.

One item to consider in closing out a job is the necessary regulatory approvals and certifications. Without securing all of the necessary documents and records, as well as performance to obtain the certificates of operation and/or occupancy, all the efforts of the prior days, months and years might unfortunately be clouded with a negative postscript. Another aspect of closeout which is essential is the turnover of warranty documentation and/or insurance certificates. These warranties and insurance are designed to address the scenario where some unexpected and unfortunate event occurs after forces have demobilized, but that "event" nevertheless produces significant impacts to the owner.

The changing and evolving nature of projects is producing even further emphasis on the importance of obtaining complete closeout performance of the contractual requirements on the given project. For example, with the increase of Green Buildings and Sustainable Engineering concepts in the industry, one of the yardsticks for measuring success on those projects is obtaining a LEED™ certification for the building. The achievement of the Certified, Silver, Gold and

Platinum rating levels is a point-driven system which, in part, follows a rigorous evaluation of document submittals delivered before, near and at the conclusion of design and construction activities. The review process itself sometimes takes months in order to obtain a response and the ultimate result. In the event that the requirements for closeout of that type of project are not closely followed and assured, this certification review may be unnecessarily impaired. Furthermore, without providing monetary incentive for obtaining the actual certification, it may not be possible for the owner to enlist the further services of the architect or contractor to address any questions that might arise in the certification review process, because the contract terms called for completion of activities and responsibilities at the time of final payment and/or obtaining the more standard certificate of occupancy, as opposed to successfully navigating the LEED™ certification process. As such, it may be appropriate for these types of jobs to provide some additional component of retainage to push out the finish line where the completion of design and construction (and "standard" payment terms) may pre-date the final certification review by the particular regulatory agency involved.

Despite the importance of the above, all of the same pale in comparison to closeout of claims and the potential for payment disputes on a given project. In Pennsylvania, some of this effort was downplayed because of the availability of an upfront waiver of mechanics' lien rights even before one shovel of dirt had been turned. However, even in Pennsylvania, changes will be occurring that will largely eliminate that feature from commercial construction projects (and higher-end residential projects). Therefore, it will become critical to obtain final waivers of liens and claims from not only the prime contractors involved with the project, but also the architect (in the event that the architect had supervisory responsibilities), subcontractors, second-tier subcontractors and suppliers to the contractor and first-tier subcontractors. It is at the crucial stage where "final" money is required and/or is changing hands that many disputes can be negotiated and resolved and the project can be closed out, thereby minimizing the specter of potential litigation that would otherwise hang in the air.

In short, in order to truly achieve success on a given construction project, the finish line cannot always be perceived as the completion of design and construction activities itself. While having the new building available for occupancy, or having the trailer demobilized from the job site may signal a milestone worthy of pride, further pride will be felt when the project can be concluded at both the physical and the documentary level. As such, even in the construction industry, the role and responsibilities of the "closer" should be carefully considered and emphasis should be given to making certain all of the details to be addressed in the close-out phase of a given project are completed and/or satisfied. In this fashion, the potential for uncertainties, unexpected claims and extended disputes over performance can be reduced to a minimum and all parties will be able to keep building for the future!

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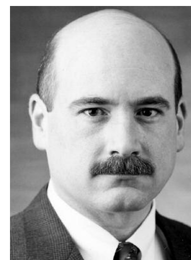

Editor's Note: Edward B. Gentilcore, a partner in the Pittsburgh office, has a practice which places heavy emphasis on construction litigation. He has represented owners, contractors, subcontractors and material suppliers in matters involving a variety of construction-related issues, including design-build, delays, extras, contract negotiation and compliance, construction safety, payment, and mechanics' liens. He has prepared and negotiated numerous agreements for a wide variety of private, public, commercial and industrial projects. Ed's concentration in construction litigation, as well as in design and construction contracts, has enabled him to serve on the Construction Litigation Committee of the ABA Section of Litigation, where he is currently Committee Liaison, and he frequently contributes articles on various construction-related topics.

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