

Recent Developments in the Application of Pennsylvania 'Prompt Payment' Statutes

The Pennsylvania legislature enacted the Contractor and Subcontractor Payment Act (CASPA) in 1994 at 73 P.S. § 501, *et seq.*, and the Prompt Payment Act (PPA) of the Pennsylvania Procurement Code in 1998 at 62 P.S. § 3901, *et seq.* The PPA applies generally to contracts and subcontracts for public work. . 62 P.S. § 3901 (West 2007). (A significant exception is that contracts for the Pennsylvania Department of Transportation are excluded from the Act.) CASPA, or the so-called "private act," applies to construction contracts, whether oral or written, located in Pennsylvania. 73 P.S. § 503 (West 2007). Both statutes set time frames for payment for construction work. The statutes also provide for interest and, in some cases, penalties and attorney fees when an owner or contractor has failed to comply with its payment obligations. The acts are not models of clarity and have created some uncertainties as to the scope of the rights and liabilities they create. Several decisions issued by the Pennsylvania courts in the past two years provide some clarification of the effect of the statutes.

Prompt Payment Act

Unless otherwise agreed by the parties to a contract, the PPA provides for interest on overdue progress and retainage payments of a government agency, contractor or subcontractor. 62 P.S. §§ 3932, 3933 (West 2007). The PPA also provides for the application of penalty interest and attorney fees when, after litigation or arbitration is commenced, the court or arbitrator finds that the government agency, contractor or subcontractor acted in bad faith. 62 P.S. § 3935 (West 2007). Bad faith is defined as an arbitrary or vexatious withholding. *Id.*

Withholding contract balances may subject the withholding party to interest and penalties depending on a courts assessment of the withholding. In light of CASPA's imprecise statutory language, the withholding party should scrutinize its justification before any payment is withheld.

It is clear the PPA applies to claims of unpaid contract balances. Less clear, however, is the application of the PPA to unpaid contract and subcontractor claims. Of significance in the last two years are decisions issued by the Commonwealth Court holding that penalty and attorneys fees provisions of the PPA apply to claims for extra work or extra costs due to interference or constructive fraud. *See Department of General Services v. Pittsburgh Building Co.*, 920 A.2d 973, (Pa. Cmmw. 2007) (characterizing failure to pay constructive fraud and active interference claim as an arbitrary and vexatious withholding subjecting the government to penalties and attorney fees under the PPA).

In *Department of General Services v. Pittsburgh Building Co.*, 920 A.2d 973, (Pa. Cmmw. 2007), the Pennsylvania Commonwealth Court considered the application of the PPA to constructive fraud and active interference claims. The court overruled a Board of Claims, or trial-level, decision that awarded the plaintiff damages and interest for constructive fraud and active interference, but denied penalty interest and attorney fees under the PPA.

The Board of Claims had held that the PPA applied only to progress payments and, further, that DGS' behavior did

also in this issue

- 3 **Ralph Finizio Moderates International Water Conference Session on Recycle and Reuse Alternatives for Municipal Wastewater Treatment Systems**

not rise to the level of arbitrary and vexatious conduct to justify an award of attorney fees under the PPA. On appeal, however, the Commonwealth Court reversed the Board of Claims' decision on the entitlement to penalty interest and attorney fees under the PPA. The Commonwealth Court held that the application of the PPA was not restricted to "progress payments" but also extended to claims of constructive fraud and active interference. The court held that the government's withholding of payment for unstable soil conditions and an attendant work stoppage constituted an arbitrary and vexatious withholding because it did not have sufficient grounds in fact and law to withhold payment so that the award of penalties and attorney fees was appropriate.

Accordingly, contractors and subcontractors subject to payment obligations under the PPA should be aware that failure to pay on claims ultimately found to be meritorious may subject the liable party to penalty interest and attorney fees. Moreover, those contractors and subcontractors who are not paid on submitted claims should make a claim in litigation or arbitration for penalties and attorney fees under the PPA. *But see James Corporation v. North Allegheny School District et al.*, 2007 Pa. Commw. LEXIS 636, No. 1268 C.D. 2007 (November 30, 2007) (holding that claimants seeking attorney fees or expenses may only recover those attorney fees or expenses associated with recovery under the PPA and not those associated with a related claim brought in the same lawsuit).

Contractor and Subcontractor Payment Act

CASPA provides that interest on any overdue payment under the act shall accrue at 1 percent per month. 73 P.S. § 505(d), 507(d), 509(d) (West 2007). In situations where arbitration or litigation is commenced to recover payment due under the act, and where it is determined that the owner, contractor or subcontractor has "wrongfully withheld" payment, CASPA imposes a penalty of an additional 1 percent per month on the amount that was wrongfully withheld. 73 P.S. § 512(a) (West 2007). CASPA provides additional guidance on what is "wrongfully withheld" providing "[a]n amount shall not be deemed to have been wrongfully withheld to the extent it bears a reasonable relation to the value of any claim held in good faith by the owner, contractor or subcontractor against whom the contractor or subcontractor is seeking to recover payment." *Id.* Finally, unlike the PPA which has one standard for penalties and attorney fees, CASPA only allows the award

of attorney fees and expenses to the "substantially prevailing party" in any arbitration or litigation. 73 P.S. § 512(c) (West 2007).

Two recent Pennsylvania Superior Court decisions consider when an owner or contractor's withholding of progress payments or retainage runs afoul of CASPA and thus entitles a contractor or subcontractor to interest, penalties and/or attorney fees. In *Rauthbrauff, Inc. v. Ravin, Inc.*, 914 A.2d 880 (Pa. Super. 2006), the Pennsylvania Superior Court considered the application of interest and penalties under CASPA. The defendant entered into a subcontract with the plaintiff for the installation of an infrared tube heating system to warm the bleacher area of an ice skating rink. The defendant, the prime contractor, refused to release retainage held on the plaintiff's subcontracted work because the heating system was not working properly and required a redesign. At trial, the court awarded the plaintiff the retainage withheld by the defendant but denied the award of penalties and interest under CASPA.

On appeal, the Superior Court partially reversed the trial court's decision, awarding the plaintiff interest on the retainage but affirming the denial of penalties. Section 509 of CASPA provides that "a contractor may withhold retainage in accordance with their agreement" but that the "retainage shall be within 30 days after final acceptance of the work." If a contractor "unreasonably withholds acceptance of work or fails to pay retainage as required by this section" then the contractor "shall be subject to the payment of interest ... on the balance due and owing on the date acceptance was unreasonably withheld or the date retainage was due and owing, whichever is applicable." The Superior Court evaluated the reasonableness of the defendant's withholding. The court found that the defendant had blamed the plaintiff's design deficiencies on the tube heating system, even though the plaintiff had no design obligations. The court found this assignment of blame unfounded and unreasonable because the plaintiff had installed the heating system in accordance with the specified design. Given the unreasonableness of the withholding, the Superior Court awarded the plaintiff interest on the retainage.

The Superior Court did not, however, award penalties to the plaintiff. Under CASPA, in situations where arbitration or litigation is commenced to recover payment due under the act, and where it is determined that the owner, contractor or subcontractor has "wrongfully withheld" payment, CASPA imposes a penalty of an additional 1 percent per

Ralph Finizio Moderates International Water Conference Session On Recycle and Reuse Alternatives for Municipal Wastewater Treatment Systems

Pepper partner Ralph A. Finizio moderated a featured session at the 69th International Water Conference, from October 26-30, 2008 in San Antonio, Texas. This session explored recycle and reuse alternatives for publicly owned treatment works (POTW).

The papers presented at the session addressed various aspects of the recent demands for increased levels of “green” water treatment, and how those demands are driving technological innovation. Mr. Finizio led discussions that covered developments in the landfill and power generation industries as well as unique wastewater treatment solutions to allow conventional sources of discharge to comply with limited POTW capability. The session also explored various techniques to reduce the impact of industrial discharges on municipal systems. Engineers presented papers on the following topics:

Keeping it Green in the Landfill – Co-Generation, Evaporation and Membrane Technology for Treatment of Landfill Leachate. This paper discussed the innovative use of a combination of reverse osmosis and evaporation technologies employed on leachate at a landfill in France.

Design Considerations for Upgrading POTWs to Treat Power Plant Wastewater Discharges. This paper provided an overview of the challenges that power plant designers and small POTWs encounter in planning and designing upgrades or replacements to effectively treat discharges from power generation facilities.

Technical Assessment of Water Reuse in Consideration of Emerging Pollutants. This paper dealt with Orange County, California’s “groundwater replenishment system,” which is one of the largest water reuse projects in the United States.

Water Conservation Strategies at Electric Generation Stations. This paper compared the impact of 16 strategies for alternative water use and control, including the benefits, risks and costs of each strategy.

Mr. Finizio is a member of Pepper Hamilton’s construction practice group. He regularly litigates and counsels clients regarding a full range of construction-related claims. Mr. Finizio can be reached at finizior@pepperlaw.com.

month on the amount that was wrongfully withheld. The Superior Court noted that CASPA provides additional guidance to what is “wrongfully withheld” providing “[a]n amount shall not be deemed to have been wrongfully withheld to the extent it bears a reasonable relation to the value of any claim held in good faith by the owner, contractor or subcontractor against whom the contractor or subcontractor is seeking to recover payment.” The Superior Court found that the record supported the trial court’s holding that the defendant subjectively expected the plaintiff to employ design service expertise, even though it was incorrect in this belief, and thus the withholding for failure to

provide such services was in “good faith.” Moreover, the Superior Court deferred to the trial court’s holding that the amount withheld bore a reasonable relationship to the value of defendant’s claim and thus affirmed the trial court’s decision to deny penalties under CASPA. Accordingly, the penalties provided by CASPA were not appropriate. With regard to attorney fees, the Superior Court remanded the case to the trial court to determine which party was the “substantially prevailing party” and thus entitled to an award of attorney fees.

In sum, the Superior Court was willing to award the plaintiff interest due under CASPA because the defendant had unreasonably imposed an extra-contractual duty of design services on the plaintiff. This withholding, however, did not rise to the level of bad faith because there was credible evidence presented that the defendant truly, though mistakenly, expected the plaintiff to employ design expertise at the time the contract was entered into.

In *Imperial Excavating and Paving, LLC v. Rizzetto Construction Management, Inc. et al.*, 2007 Pa. Super LEXIS 3540, No. 3339 EDA 2006, (Pa. Super 2007), the Pennsylvania Superior Court again considered the award of interest and penalties under CASPA. The general contractor defendant entered into a subcontract with the plaintiff to remove, grade and compact topsoil on a soccer field. The owner ultimately rejected the work and withheld from the defendant contractor \$120,000 in payment for other services. The defendant in turn withheld payment due to the plaintiff subcontractor for other work performed and retainage to cover amounts necessary to cover the owner's complaints. The withholding totaled \$262,330. The Superior Court affirmed the trial court's decision that the plaintiff had fully and satisfactorily performed its contractual obligations. Accordingly, the withholding was "unreasonable" and thus the award of interest under CASPA was appropriate. Next, the Superior Court affirmed the trial court's award of penalties under CASPA. As stated above, under CASPA, amounts are "wrongfully withheld" where they do not bear a reasonable relation to a good faith claim of the owner, contractor or subcontractor. The Superior Court held that the trial court correctly reasoned that the

\$262,330 withheld from plaintiff did not bear a "reasonable relation" to the \$120,000 in question.

Accordingly, contractors and subcontractors subject to payment obligations under CASPA should be aware that withholding contract balances may subject the withholding party to interest and penalties depending on a court's assessment of the withholding. In light of CASPA's imprecise statutory language, the withholding party should scrutinize its justification before any payment is withheld. *But see ILM Systems v. Suffolk Construction Co., Inc.*, 252 F. Supp. 2d 151 (E.D. Pa. 2002) (holding that CASPA only applies to progress and final payments and not to delay claims). Moreover, the "substantially prevailing party" in the litigation may be awarded its attorney fees. *Michael F. Zavatichen, Jr. v. RHF Holdings, Inc.*, 907 A.2d 607 (Pa. Super. 2006) (holding that the decision as to whether a party substantially prevailed is left to the trial court's discretion).

Authors:

Kenneth I. Levin
215.981.4472
levink@pepperlaw.com

Joseph T. Imperiale
215.981.4124
imperialej@pepperlaw.com

Pepper Hamilton LLP Attorneys at Law

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