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Attention Defense Contractors: Mandatory Cyber Incident Reporting Requirements

by Brent N. Mackay, Partner

Global technology company Yahoo! recently admitted it was the victim of a colossal data breach potentially affecting hundreds of millions of its users. Although most cyber incidents encountered by businesses today are significantly smaller in scale, unfortunately, such incidents remain a current fact of life. The question is not "if" a cyber incident will happen, but "when." Companies doing business with the government may have certain reporting obligations when such incidents occur and should act accordingly.

On October 2, 2016, the Department of Defense ("DoD") published a final rule implementing mandatory cyber incident reporting requirements for defense contractors, effective November 3, 2016 (the "Final Rule"). (*See* 32 C.F.R. Part 236). This article examines generally what the requirements are, to whom they apply and when, and other related considerations.

Definition Of A "Cyber Incident"

As a preliminary matter, "cyber incident" is defined as "actions taken through the use of computer networks that result in a compromise or an actual or potentially adverse effect on an information system and/or the information residing therein." (*See* 32 C.F.R. 236.2). Examples of "cyber incidents" include encounters with malicious software, such as trojan horses and spyware, as well as forms of cyber eavesdropping, to name a few.

Types Of "Cyber Incidents" Requiring Reporting

A contractor has an obligation to report a "cyber incident" when it results in "an actual or potentially adverse effect on a covered contractor information system or covered defense information residing therein, or on a contractor's ability to provide operationally critical support." (32 C.F.R. § 236.4(b)).

"Covered" defense information in this context essentially refers to unclassified information relating to the contractor's performance under the contract, that could potentially harm the government if exported, or is identified by the government as requiring safeguarding. (32 C.F.R. § 236.2). A "covered" information system is one that processes, stores, or transmits "covered" defense information.

Contractors should be aware that cyber incident reporting involving classified information on classified contractor systems should be in accordance with the National Industrial Security Program Operating Manual (NISPOM).

Reporting Requirements

If the contractor's circumstances match the foregoing, then it must (1) conduct a review for evidence of compromise of covered defense information, and (2) submit a cyber incident report to the DoD. The contractor's review should, at a minimum, identify compromised computers, servers, specific data, and user accounts. As part of their review, contractors must also analyze covered information systems that were a part of the incident, as well as those systems on the contractor's network that may have been accessed. (32 C.F.R. § 236.4(b)(1)).

The contractor's cyber incident report should include as much information as the contractor has at the time, and must be supplemented with any additional information thereafter. (32 C.F.R. § 236.4(c)). Generally, the report should include the known details about what occurred, to whom it occurred, what was or may be affected and how, as well as information concerning the underlying contract. Specifically, the report should contain the information obtained from its review for evidence of compromise, including the date the incident was discovered, impact to covered defense information, the contractor's ability to provide operationally critical support, locations and types of compromise, a description of the technique/method used in the cyber incident, and the outcome of the incident (i.e., successful compromise, failed attempt, unknown).

The affected contractor should also identify the incident location and facility Commercial And Government Entity (CAGE) codes and Data Universal Numbering System (DUNS) Number, as well as any DoD programs, platforms or systems involved. Additionally, the incident report should identify all applicable clearance levels, point of contact information for contractor and contract number(s) or other type of agreement potentially affected. (*See* http://dibnet.dod.mil/staticweb/ReportCyberIncident.html for additional requirements).

Before it can submit an incident report, the contractor must first obtain a DoD-approved medium assurance certificate. (32 C.F.R. § 236.4(e)). This certificate permits contractors to securely communicate with the DoD and authenticate themselves.

Also, if malicious software is discovered and isolated, such as a trojan horse, a contractor must disclose such to the DoD. (32 C.F.R. § 236.4(h)). Additionally, a contractor must preserve media (images or data) known to be affected by a cyber incident for at least 90 days from reporting the incident to the DoD. (32 C.F.R. § 236.4(i)). This allows the DoD to request or decline the affected media.

Subcontractor Reporting

Subcontractors are required to simultaneously report to both the prime contractor and the DoD. Consequently, contractors, in addition to expressly including (or incorporating by reference) the mandatory reporting requirements in any applicable contract with the DoD, must ensure they "flow down" the requirements to applicable subcontracts. (32 C.F.R. § 236.4(d)).

Who Must Comply With The Reporting Requirements

The mandatory reporting requirements apply to contractors or subcontractors (including lower tiered subcontractors) who have entered into agreements with the DoD. This embraces "all forms of agreements," including contracts, grants, cooperative agreements, other transaction agreements, technology investment agreements, and any other type of legal instrument or agreement.

When To Report A "Cyber Incident"

A contractor must "rapidly" report a "cyber incident" to the DoD, essentially within 72 hours of discovery. (32 C.F.R. § 236.4(b)(2), § 236.2). A subcontractor must simultaneously report such incidents to the DoD and the prime contractor. (32 C.F.R. § 236.4(d)).

Other Reporting Requirements

Defense contractors should note that reporting under the Final Rule does *not* relieve it of any other cyber incident reporting obligations they may have, including any reporting requirements that may exist in the underlying contract or agreement or in other governmental statutes or regulatory requirements. (32 C.F.R. § 236.4(p)).

Consequences For Non-Compliance

Contractors should also not be fooled into thinking there are no consequences for non-compliance with the new reporting requirements simply because the Final Rule does not impose any new or additional consequences. Contractors are still subject to any existing generally applicable contractor compliance mechanisms. Additionally, a contracting officer may take whatever remedial actions he or she deems necessary for non-compliance with the requirements of the underlying contract or agreement.

Conclusion

In summary, under the Final Rule, the DoD has obligated contractors and subcontractors to conduct a review and submit a report within 72 hours of discovering a qualifying "cyber incident." Contractors should be aware of additional reporting requirements that may exist in any underlying agreement or in other applicable statutes or regulations.

Each particular "cyber incident" is unique and an affected contractor (or other organization) should consult with a government contracts attorney to review the applicable rules, regulations, and contractual requirements.

GAO Bid Protests: A Step-By-Step Guide To Navigating The Labyrinth

by Donna Tobar, Partner

When federal procurement agencies fail to adhere to statutory or regulatory guidelines for procurement, solicitors or potential solicitors may pursue a bid protest to challenge the contracting agency's process or decision. There are numerous circumstances which may trigger a bid protest, including: (1) soliciting or requesting offers; (2) cancelling solicitations or offers; (3) awarding or proposing to award a contract; (4) terminating or cancelling a contract based on improper award; and (5) converting functions performed by the government to the private sector.

As soon as the contractor learns of the circumstances which would trigger a possible bid protest, the contractor needs to take immediate action in order to meet the strict deadlines for properly proceeding with a bid protest through the complex and fast-moving process. This article outlines the steps to be taken for a bid protest at the Government Accountability Office ("GAO").

First Step: Request Formal Debriefing

Before proceeding with a bid protest, an unsuccessful offeror should request a formal debriefing from the contracting agency to obtain information regarding: (1) the unsuccessful offeror's weaknesses and past performance information; (2) the evaluated cost and technical ratings of the successful offeror in comparison to the unsuccessful offeror; (3) overall rankings of all offerors; (4) the rationale for the award; and (5) responses to questions about the source selection process and whether the applicable authorities were followed. An unsuccessful offeror should request the debriefing in writing within 3 calendar days of notification from the contracting agency of exclusion from the competition or award to a competing offeror.

Second Step: Determine Proper Forum For Bid Protest

Next, the contractor must determine the forum in which to proceed with the bid protest: (1) the GAO (to the extent subject to GAO jurisdiction); (2) the U.S. Court of Federal Claims ("COFC"); or (3) the procuring agency. Each of these forums has their own procedures, but this article will focus on the GAO procedures because the GAO is the most commonly used forum. There are numerous factors to consider when making a determination regarding the forum in which to protest a bid. It is highly recommended to consult knowledgeable legal counsel to determine the best forum.

- Who Is Entitled To Submit A Bid Protest With GAO?

Under GAO regulations, a bid protest can only be pursued by an "interested party" or any "actual prospective bidder or offeror whose direct economic interest would be affected by the award of the contract or by failure to award the contract." Subcontractors and suppliers do not have standing to pursue a bid protest.

- Legal Basis For A Bid Protest

The GAO will not substitute its own judgment for that of the contracting agency or conduct a *de novo* review of the contracting agency's procurement actions and procedures. Instead, the GAO will determine whether the contracting agency properly complied with procurement statutes and regulations and whether the contracting agency had a reasonable basis for its decision and adequate documentation thereof. Some examples of protest grounds include: (1) failure to evaluate in accordance with stated evaluation criteria; (2) unequal discussions; (3) failure to evaluate for price realism; (4) unreasonable evaluation of criteria; (5) evaluation based on unstated evaluation criteria; (6) affiliation; and (7) decisions regarding set-aside or sole source.

The protester will also have to demonstrate competitive prejudice – i.e., but for the contracting agency's actions, the protester would have had a substantial chance or reasonable likelihood of award.

Third Step: Determine Deadline For GAO Bid Protest

A bid protest must be filed with the GAO either: (1) before the bid opening or by the specified time *if* the alleged violations are apparent before bid opening or the time set for receipt of initial proposals; (2) within 10 calendar days after the alleged violations become known or should have become known, whichever is earlier; or (3) if seeking a stay of the award and/or contract under the Competition in Contracting Act ("CICA"), within 5 calendar

days after the debriefing date offered to an unsuccessful offeror for any debriefing that is requested and, when requested, is required. It is particularly important to file within the period for an automatic stay of award or performance to ensure that a successful protestor may be afforded proper relief. It is highly recommended to consult legal counsel, as there are nuances which impact these timeframes.

Fourth Step: Submit Bid Protest To GAO

Within the proper timeframe, a protesting contractor must submit a written protest which includes: (1) a detailed statement of the legal and factual grounds for the protest, including copies of supporting documents; (2) sufficient information to determine that the protesting contractor qualifies as an "interested party;" (3) sufficient information to demonstrate that the protest is timely; (4) a request for a ruling by the Comptroller General of the United States; and (5) a statement of the relief requested.

At the time of the bid protest submission, the protesting contractor may also: (1) request documents from the contracting agency; (2) seek a protective order to protect confidential and/or proprietary information during the proceedings; and (3) request a hearing, explaining the reasons that a hearing is needed to resolve the protest (hearings are rarely granted, however).

To the extent that the protesting contractor wants expedited review under the GAO's express option, the protesting contractor must submit a request within 5 calendar days of filing the protest.

Fifth Step: Obtain Contracting Agency's Response

Once the bid protest is filed, the GAO will notify the contracting agency, thereby starting the clock on the agency's 30 calendar days to respond to the bid protest (absent circumstances which may alter the response timeframe). The contracting agency's response must include: (1) the contracting officer's statement of facts and best estimate of the contract value; (2) a memorandum of law; and (3) all documentation related to the bid or solicitation and evaluation thereof.

Sixth Step: Submit Comments To Contracting Agency's Response

After receipt of the contracting agency's response to the bid protest, the protesting contractor has 10 calendar days to submit written comments. If the contracting agency's response was required under the shorter 20 day timeframe, the protesting contractor's response is due within 5 days after the contracting agency's response. If the protesting contractor needs additional documents whose existence became evident after receipt of the contracting agency's report, the protesting contractor must request those additional documents within 2 calendar days of discovering the existence of the documents. Based upon the discovery of information and documentation during this process, within 10 days of discovery of additional bases for protest, the protesting contractor can then file additional or supplemental protest grounds.

Seventh Step: Receive Recommendation From GAO

Generally, the GAO must issue a recommendation within 100 days under the normal timeframe or within 60 days under the express option. If a hearing has taken place, the protesting contractor must file written comments on any hearing within 5 calendar days of the hearing.

Eighth Step: Options Upon Unsuccessful GAO Bid Protest

To the extent a protesting contractor is dissatisfied with the GAO's determination of a bid protest, there are two options: (1) request that the GAO reconsider its determination; or (2) appeal the GAO decision by filing a bid protest with the COFC.

- GAO Reconsideration

To request GAO reconsideration, a protester must file a request within 10 calendar days after the basis for reconsideration is known or should be known, whichever is earlier. The request for reconsideration must include a detailed statement of the factual or legal bases for reconsideration, including any legal errors or failure to consider information.

- COFC Appeal

The protester can file a lawsuit with the COFC alleging that the contracting agency's procurement actions were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law."

Conclusion

Navigating the federal government contracting arena is a complex task requiring knowledge, skill, and experience. In order to avoid "traps," maximize the chances for success, and obtain a stay of award or performance during the pendency of the bid protest, it is highly recommended that legal counsel be obtained to evaluate a possible protest as soon as possible.

C. William Groscup

When Indemnity Provisions Apply: A Brief Overview Of Anti-Indemnity Statutes In Virginia And Maryland

by C. William Groscup, Senior Partner and George E. Stewart, III, Associate

George E. Stewart, III

Indemnity provisions are a common feature in construction contracts. These clauses essentially act as risk-transfer devices, wherein one party, the indemnitor, agrees to defend, indemnify, or hold harmless another party, the indemnitee, for acts or omissions relating to a construction project. In other words, the contractor-indemnitor agrees to reimburse the project owner-indemnitee for losses resulting from a claim brought by a third party. In the context of construction contracts, project owners often include indemnity provisions to shift as much risk as possible to the general contractor and architect. The general contractor and architect, in turn, shift this risk down to their subcontractors and suppliers, thereby creating a chain of indemnification stretching from the project owner to the individual subcontractors.

Given the nature of this one-way stream of liability and the inequalities of bargaining power among owners, architects, contractors, and subcontractors, it should come as no surprise that project owners sometimes include overly broad indemnity provisions where an indemnitor assumes the risk for the indemnitee's own negligence. To combat this, state legislatures have passed a variety of anti-indemnification statutes to void such indemnification arrangements as being against public policy. In fact, a vast majority of the states have enacted some form of legislation governing indemnity clauses relating to construction contracts.

The purpose of these anti-indemnity statutes is simple: to incentivize project owners (and general contractor-indemnitees) to take full responsibility for their actions and not simply foist their liability onto hapless subcontractor-indemnitors. Legislatures and courts across the country almost universally agree that this is an important public policy issue, especially in the construction context where negligent performance could pose serious risks to onsite workers and even the general public. Anti-indemnity statutes therefore override the parties' freedom to contract and compel indemnitees to perform contracts with the upmost care by holding them responsible for their actions.

While each of the statutes aims to prohibit indemnification for losses caused by the negligence of the indemnitee, the scope and impact of these statutes vary widely from one jurisdiction to the next. Of the states that have formal anti-indemnity statutes, a division exists between those states that prohibit an indemnitor from indemnifying an indemnitee for the indemnitee's *sole* negligence and states that prohibit an indemnitor from indemnifying an indemnitee for *any* of the indemnitee's own negligence, sole or partial. To further complicate matters, states that may have similar statutes often have subtle differences that ultimately affect the scope and applicability of indemnity clauses. This effect can be illustrated by comparing the nearly identical anti-indemnity laws in Virginia and Maryland. Although the two statutes are similar in appearance, their application in practice differs based on the particular language chosen by the legislature and the subsequent case law interpreting it.

Virginia's anti-indemnity statute is contained in § 11-4.1 of the Virginia Code:

> Any provision contained in any contract relating to [ ] construction . . . by which the contractor performing such work purports to indemnify or hold harmless another party to the contract against liability for damage arising out of bodily injury to persons or damage to property suffered in the course of performance of the contract, *caused by or resulting solely from the negligence* of such other party or his agents or employees, is against public policy and is void and unenforceable.

Originally, § 11-4.1 was viewed as a sole negligence statute by most commentators, meaning that it would not apply to indemnity clauses that indemnified a party against a combination of the indemnitee and indemnitor's concurrent negligence. The decision in *Uniwest Constr., Inc. v. Amtech Elevator Servs., Inc.*, 699 S.E.2d 223, 230 (Va. 2010), *opinion withdrawn in part on reh'g*, 714 S.E.2d 560 (2011), however, clarified the scope of § 11-4.1 by holding that if an indemnification clause could *possibly* indemnify a contractor for its own negligence, even if its negligence was not the sole cause, then that clause was void under § 11-4.1. Specifically, because the phrases "caused by" and "resulting solely from" were disjunctive in the statute's language, the court interpreted the statute as voiding any indemnification provision that attempts to impose damage caused by the negligence of the indemnitee upon the indemnitor, regardless of the indemnitor's degree of fault.

While Maryland's anti-indemnity statute is similar in appearance to that of Virginia, Maryland courts have arrived at a different conclusion in its application. Pursuant to § 5-401 of the Maryland Code:

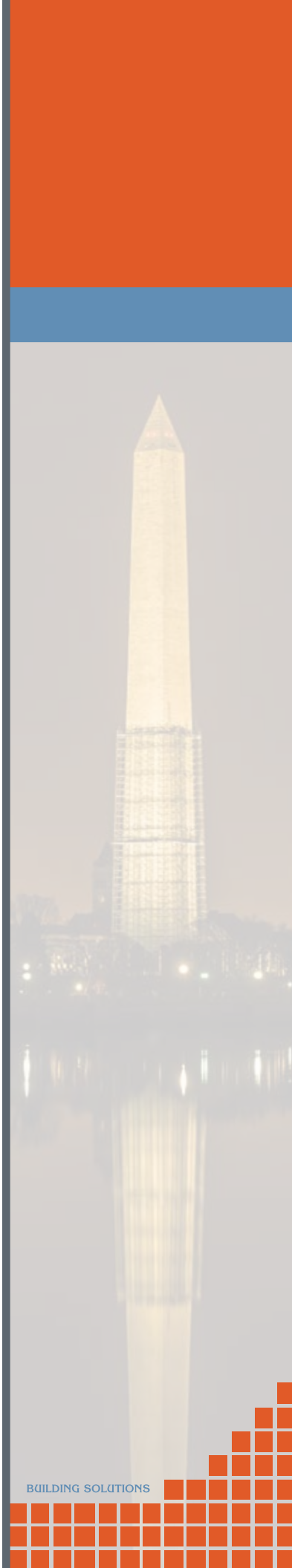
> A [construction contract] . . . purporting to indemnify the promisee against liability for damages arising out of bodily injury to any person or damage to property *caused by or resulting from the sole negligence* of the promisee or indemnitee, or the agents or employees of the promisee or indemnitee, is against public policy and is void and unenforceable.

At first glance, the two code provisions appear to be largely the same. Both Virginia and Maryland courts hold that any indemnity provision in a construction contract which purports to indemnify the indemnitee against liability for damages caused by the indemnitee's sole negligence is rendered void and unenforceable by law. *See Uniwest*, 699 S.E.2d at 230; *Heat & Power Corp. v. Air Prod. & Chemicals, Inc.*, 578 A.2d 1202, 1206 (Md. 1990). In either Virginia or Maryland, a contractor-indemnitor will not be held liable for the negligence or wrongful acts of a project owner-indemnitee when the project owner-indemnitee is *solely* responsible.

Maryland and Virginia courts have come to different conclusions, however, when the contractor-indemnitor and project owner-indemnitee are concurrently liable. Unlike Virginia, Maryland courts explain that their statute does not contain the disjunctive language found in Virginia's anti-indemnity law. Thus, in Maryland, where "a particular contract provision or sentence can properly be construed as reflecting two agreements, one providing for indemnity if the [indemnitee] is solely negligent and one providing for indemnity if the [indemnitee] and [indemnitor] are concurrently negligent, only the former agreement is voided by the statute." *Heat & Power*, 578 A.2d at 1206. Accordingly Maryland courts will only void those indemnity clauses that indemnify the project owner-indemnitee for its sole negligence.

Virginia and Maryland law demonstrates how two very similar anti-indemnification statutes can yield opposite results. Courts in either state have essentially concluded that Virginia's "caused by or resulting solely from the negligence" statutory language is materially different from Maryland's "caused by or resulting from the sole negligence" wording. In practice, this seemingly insignificant variation in wording signifies that a contractor in Virginia will never be held liable for the negligence of the project owner, no matter the degree of the contractor's involvement, while a contractor in Maryland can only escape liability if the contractor is able to show that it was completely without fault for the project owner's negligence. Thus, if a Maryland court determines that the contractor contributed to the negligence in any amount, the indemnity provision will be considered valid. That being said, it is unclear how Maryland courts would proceed under this rationale—although the indemnity clause would not be stricken, Maryland courts have not specifically addressed how liability would be apportioned between the indemnitor and indemnitee when both are concurrently responsible for the delay or damage in question.

To successfully navigate anti-indemnity provisions in construction contracts, contractors must know more than whether their jurisdiction has an anti-indemnity statute – contractors must understand how the courts in their jurisdiction typically interpret and apply anti-indemnity laws in order to properly avail themselves of this statutory protection. Even seemingly identical statutes can have significant distinctions involving minute details, such as the disjunctive use of the word "sole." Therefore, contractors should seek legal advice when dealing with indemnity provisions because the particular wording of the anti-indemnity statute and the applicable state law will almost certainly impact the enforceability of the indemnity clause.



Pennsylvania Supreme Court Finds That A Municipality That Acts In Bad Faith May Still Avoid Liability For Attorney's Fees And Penalty Under The Procurement Code

by Kevin J. McKeon, Senior Partner

The Pennsylvania Supreme Court recently held that when a jury finds that a municipality is not only in breach of contract, but also has acted in bad faith towards a contractor, the trial judge still retains the ultimate discretion to determine whether to award penalty and attorney's fees under the Procurement Code.

In *A. Scott Enterprises, Inc. v. City of Allentown*, 142 A.3d 779 (Pa. 2016), the contractor discovered contaminated soil while excavating to construct a new road, and the work was suspended. The city knew that there might be contamination, but did not disclose that knowledge in the bid documents. The city also knew that soil testing was recommended, but did not perform the testing. The city refused to authorize the contractor to perform on a force account basis and the work never re-commenced.

Instead, the contractor sued to recover its losses, and the jury found that the city had breached the contract and acted in bad faith. As a result, the contractor requested an award of penalty and attorney's fees under Section 3935 of the Commonwealth Procurement Code. Section 3935(a) indicates that a court "may award" a 1% per month penalty on "the amount that was withheld in bad faith," while Section 3935(b) indicates that the prevailing party "may be awarded a reasonable attorney fee" if the government "acted in bad faith."

In this case, the trial judge examined the same evidence heard by the jury, as well as the language of Section 3935. She determined not only that she had the discretion to decide whether to award attorney fees and penalty, but decided not to issue such an award. The contractor appealed, and the commonwealth court decided that such an award was mandatory, stating:

> The purpose of the Procurement code is to "level the playing field" between government agencies and contractors. It advances this goal by requiring a government agency that has acted in bad faith to pay the contractor's legal costs, as well as an interest penalty. Otherwise, the finding of bad faith is a meaningless exercise with no consequence for the government agency found to have acted in bad faith.

With this finding, the commonwealth court remanded the case back to the trial judge to calculate and award the appropriate penalty and attorney's fees to the contractor. In the meantime, however, the Pennsylvania Supreme Court reviewed the decision and overruled the commonwealth court by agreeing with the trial judge's original ruling. More specifically, after a lengthy analysis of precedent and after closely examining the language of Section 3935, five members of the court agreed with the trial judge, while one member issued a dissenting opinion.

As a result, barring action by the state legislature to amend the Procurement Code, contractors must now overcome two hurdles to establish entitlement to a penalty and attorney's fees, and to make a finding of bad faith something more than the "meaningless exercise with no consequence" as described by the commonwealth court. First, they must convince the jury that a municipality has acted in bad faith. Second, the contractor must also convince the trial judge not that penalty and attorney fees "may" be awarded, but that they *should* be awarded.

Albert L. Chollet, III

Preserving Mechanics' Lien Rights in Bankruptcy Proceedings

by Albert L. Chollet, III, Partner and Aniuska Rovaina, Associate

Aniuska Rovaina

The filing of a bankruptcy petition by a party to a construction project can be a significant disruption that introduces uncertainty, added costs, and procedural challenges for interested parties. For those entities that are creditors in bankruptcy and are seeking to secure payment for work performed, the challenges can be numerous. The interplay of federal bankruptcy law and state mechanics' lien law adds complexity to the process of securing payment for work performed. A lien claimant must often satisfy statutory preconditions under strict time limitations while not running afoul of substantive and procedural protections afforded to the bankrupt debtor.

Mechanics' liens are a common device to secure the payment of labor, services, and material used to improve a property. While all states have mechanics' lien laws, statutes vary significantly from jurisdiction to jurisdiction as to the requirements for lien creation, perfection, continuation and enforcement. In some jurisdictions, a mechanics' lien arises when a claimant serves a notice of the lien as required by state law. Other jurisdictions allow the lien to arise either when the contract for material and services was executed or when the material and labor was first provided. In others, a lien may arise when the claimant formally records a lien with the register of deeds within a specific time period in the county where the real property is located.

State laws similarly diverge in respect to a claimant's priority over other validly created and perfected liens. For instance, provided that a claimant took the necessary steps to perfect its lien within the required time period, the lien may relate back to the day where labor and delivery of materials commenced, and in effect, give the claimant priority over other interests in connection with the real property.

The timing and procedure to assert and perfect a lien is important when preserving a claimant's rights. Thus, a claimant that fails to enforce its lien as prescribed by the applicable state law jeopardizes its mechanics' lien rights and ability to recover.

The lack of uniformity among mechanics' lien statutes ensures that no one rule applies to all situations. Contractors who work in multiple jurisdictions must therefore remain mindful of the jurisdiction-specific nature of the rules or else risk negative consequences. Depending on the time and procedural constraints under a state statute, a mechanics' lien may receive more or less protection in various bankruptcy scenarios.

The Bankruptcy Petition, The Automatic Stay, And Mechanics' Liens

The filing of a voluntary bankruptcy petition triggers the automatic stay under Bankruptcy Code, 11 U.S.C. §362(a). The automatic stay works by: (1) providing protection to the debtor from creditors attempting to take action against the debtor's property; (2) offering equality of distribution of the debtor's assets among claimants; and (3) permitting a more orderly administration of the bankruptcy case.

The automatic stay remains in effect until a judge lifts the stay at the request of a claimant, the debtor is discharged, or the item of property is no longer part of property of the bankruptcy estate. This means that, until one of those three scenarios occurs, the automatic stay generally prohibits the filing or continuation of a lawsuit, any collection calls, demands for payment, repossession of property, foreclosure sales, and garnishment or levies. A creditor who willfully or intentionally violates the automatic stay runs the risk of liability for actual damages, including attorneys' fees and costs, and even punitive damages under appropriate circumstances.

At the commencement of a bankruptcy case, creditors interested in pursuing their lien rights should have a clear understanding of

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two provisions under §362(a) relating to the attachment, perfection and enforcement of a lien on the property of a debtor or property of a debtor's estate. Section 362(a)(4) prohibits "any act to create, perfect or enforce any lien against property of the estate." Section 362(a)(5) prohibits "any act to create, perfect or enforce against property of the debtor any lien to the extent that such lien secured a claim that arose before the commencement of the case." The latter provision extends protection of the stay to property acquired after the date of the bankruptcy filing, exempt property, abandoned property, and any other property excluded from the estate under section 541.

Courts in various jurisdictions have interpreted these provisions to prohibit a claimant from pursuing actions necessary to perfect or maintain a mechanics' lien claim against a debtor's property. For example, in *In re Excel Engineering, Inc.*, 224 B.R. 582 (Bankr. W.D. Ky. 1998), a subcontractor filed a statutory lien under state law against funds owed to the general contractor after the general contractor had filed for bankruptcy. The court held that this action violated the automatic stay because the subcontractor did not have an interest in the funds since the subcontractor did not properly file and serve notice of the lien until after the debtor's petition was filed in bankruptcy. Similarly, in *In re Baldwin Builders*, 232 B.R. 406 (Bankr. 9th Cir. 1999), a landscaping contractor recorded a mechanics' lien against an owner's property. Subsequently, the owner filed its bankruptcy petition. The claimant filed a complaint to foreclose the lien, but it did not serve the complaint on the bankrupt debtor. Even though the claimant did not serve the complaint, the bankruptcy court concluded that the filing of the foreclosure complaint was a violation of the automatic stay and the complaint was therefore void.

Exceptions To The Automatic Stay And Lien Rights

Bankruptcy Code §362(b) provides certain exceptions to the automatic stay that allow a mechanics' lien claimant to perfect its lien after a bankruptcy has been filed. Although Section 362(b) does not provide an exception for the creation of the lien, which is prohibited by 362(a)(4) and (5), the section does permit a claimant to perfect, maintain and continue the perfection of its lien. Specifically, Section 362(b)(3) prescribes protection from the automatic stay for a claimant who had an interest in property predating the bankruptcy petition but had not perfected its interest at the time of the bankruptcy filing.

For the exceptions under Section 362(b) to apply, the claimant must first satisfy the notice requirement pursuant to Section 546(b). If a claimant's lien arose *prior to* the filing of the bankruptcy petition under applicable state law, then Section 546(b) allows for the perfection or continuation of perfection of the lien *after* the bankruptcy petition has been filed. Clearly, this analysis begins with a determination of the claimant's rights under state law at the time of the bankruptcy filing.

If a lien claimant is prohibited by the automatic stay from foreclosing its lien claim but is under strict time limitations to file a foreclosure action, the Bankruptcy Code does provide some options. Section 546(b)(2) permits the claimant, who is required by state law to commence a foreclosure action to enforce its mechanics' lien, to provide written notice of its claim in the bankruptcy proceedings in lieu of filing of the foreclosure. However, the section provides little guidance for how to properly provide notice when attempting to assert or enforce a lien, and in practice the notice requirement under section 546(b)(2) can vary by jurisdiction. In *In re McCord*, 219 B.R. 251 (Bankr. E.D. Ark. 1998), a contractor filed suit to foreclose a mechanics' lien two hours and fifty minutes after homeowners filed for bankruptcy. Under Arkansas law, a mechanics' lien is perfected when a complaint to foreclose the lien is filed with the clerk of the court. The bankruptcy court found that the contractor's lien arose and related back to the time of performance since the filing had satisfied the state requirements for perfection. Accordingly, the contractor did not violate the automatic stay.

In comparison, under Alabama law, in order to maintain a mechanics' lien, a general contractor is required to first file a verified statement of the lien within six months after the last work was performed and then commence an action in state court to enforce the lien within six months after the maturity of the debt secured by the lien. In *In re Cook*, 384 B.R. 282 (Bankr. N.D. Ala. 2008), the court found that a contractor's post-petition filing of an amended petition seeking enforcement of its lien did not provide sufficient notice under Section 546(b)(2), and therefore violated the automatic stay.

While Section 362(b) may allow for a claimant to perfect its lien post-petition, claimants should be aware at the commencement of a bankruptcy case of the relationship between state laws that will permit the assertion and enforcement of those liens and whether the Bankruptcy Code authorizes the application of any exceptions.

When a general contractor files for bankruptcy, fewer issues arise regarding the protection of a subcontractor's lien. In situations where a subcontractor attempts to collect from a debtor-contractor, the automatic stay will remain effective. Under certain jurisdictions involving earmarking, statutory trust fund, or constructive trust, it is often common for subcontractors to claim that certain funds in the debtor's possession are beyond the control of the bankruptcy trustee and should therefore be disbursed directly to the subcontractor. In *In re Crea*, 31 B.R. 239 (Bankr. D. Minn. 1983), the court concluded that under state law there was no trust relationship between a general contractor and subcontractor that would assist the subcontractor in avoiding the effects of the Bankruptcy Code and automatic stay.

However, a contractor's bankruptcy should not disrupt efforts to perfect or foreclose a lien on a non-bankrupt owner's property. For instance, in *In re Perry*, 312 B.R. 723 (Bankr. M.D. Ga. 2004) a subcontractor's mechanics' lien against an owner's real property did not violate the automatic stay entered as a result of a general contractor's bankruptcy because the lien did not attach to any of the debtor's property. Notwithstanding, a creditor should remain mindful of whether state law requires naming a debtor as a defendant in a foreclosure action as a real party in interest.

A Comment On Best Practices For Lien-Claimant Creditors

The wide variation of lien statutes among states creates a complex landscape for multi-jurisdiction contractors. As a result, it is imperative to understand the relationship between the Bankruptcy Code and the mechanics' lien state laws and remain mindful of the underlying substantive state law that give rise to the lien rights. At the outset of a bankruptcy case, in order to avoid a lapse of lien rights, claimants should take immediate action to assess their rights and obligations under applicable state law. At a minimum, this means understanding whether the lien claim arose pre-petition or post-petition, determining whether any post-petition steps will be necessary to perfect the claim and whether any exceptions to the automatic stay are present, and identifying all statutory deadlines for perfection and enforcement of the lien claim. Because statutory time limitations can be unforgiving and procedural actions in bankruptcy court can present practical challenges or prove time-consuming, time is usually of the essence in these matters. By undertaking an immediate assessment and engaging counsel as quickly as possible, the claimant will set itself up for the best chance of preserving and pursuing all available rights.

Watt Tieder newsletters are posted on our website, www.watttieder.com, under the Resources Tab. If you would like to receive an electronic copy of our newsletter, please contact Peggy Groscup at: **pgroscup@watttieder.com**

PS Consulting
GcilA member firm

PS Consulting is a Paris based firm founded in 2003 by UK barrister and civil engineer Geoff Smith and US attorney and civil engineer Jim Perry. Both have built their careers servicing contractors' and owners' needs at all phases of the project life cycle, in France and throughout the World. The firm is particularly focused on international arbitration and dispute boards. In 2016, Guillaume Sauvaget joined the firm from the French contractor Colas SA.

Like its Alliance partner firms, PS Consulting specializes in multicultural international projects and disputes, bridging the gap between common and civil law jurisdictions and also industry customs and practices in both the construction process and the manner in which dispute resolution functions.

PS Consulting is a leading expert in Dispute Boards internationally. Their partners include two FIDIC President's List Adjudicators and a recipient of the Dispute Resolution Board Foundation's prestigious Al Mathews Award. Specializing in FIDIC contracts, their partners sit on major project Dispute Boards from Peru to Indonesia and Bangladesh and throughout Africa, Central Europe and Central Asia.

In arbitration, the firm handles high value cases in industrial projects, oil & gas, power, infrastructure and the building sector all over the World for contractors and owners. PS Consulting partners frequently sit as arbitrators in institutional arbitrations, or are appointed as experts.

Geoff Smith

Jim Perry

The Evolution Of Global Claims And *John Doyle Construction Limited v. Laing Management (Scotland) Limited*

by Geoff Smith and Jim Perry

A recent decision of the Scotland Court of Session (*John Doyle Construction Limited v. Laing Management (Scotland) Limited* (2004)), relying heavily on the position in the Unites States, has re-examined the complexity of proving claims in construction and should result in more equitable outcomes in the event that it is impossible or impracticable to isolate the various causes of damage. In the future, the loss is to be apportioned on the basis of the relative importance of the causative events, in producing the loss.

It has long been recognised that in complex situations, it may be difficult or impossible to accurately evaluate the damage arising from each of a number of interacting causes, but that this difficulty should not prevent recovery from the defendant.

It was also clear that a global claim should not be treated as *prima facie* bad and that a composite amount might be recovered with respect to the combined effect of a number of causative events for which the Employer was responsible. Moreover, this causative link should be viewed with 'common sense.'

It is not unusual to see responses to contractors' claims in which it is stated that the contractor has failed to take account of his own delays. Reliance is placed on such statements, often broad in nature, in order to deny responsibility for the damage claimed.

In such circumstances, is it correct and acceptable for the employer to profit from the situation?

This debate may have been settled, at least in Scotland, by the recent ruling of the Scottish Court of Session on appeal from the first instance decision in the 2002 case of *John Doyle Construction Ltd. v. Laing Management (Scotland) Limited*, (2002) BLR 393.

In this case, John Doyle had submitted a claim, part of which related to disruption due to a combination of factors. In an action to have this part of the claim dismissed, Counsel for Laing Management submitted that the relevancy of a global claim depended on two assumptions holding true: that the Claimants were not themselves responsible to any material extent for the increased costs in respect of which the global claim was advanced and that the Defendants were responsible for all of the causal factors that contributed to the increased costs. It was submitted that John Doyle had caused some of the delay and therefore one of the essential factors for the global claim to succeed was absent.

On appeal, Lord Drummond Young set out in detail the reasoning of the Court of Session:

> *If a global claim is to succeed … the contractor must eliminate from the causes of his loss and expense all matters that are not the responsibility of the employer….*
>
> *In the second place, the question of causation must be treated by 'the application of common sense to the logical principles of causation.' … If an item of loss results from concurrent causes, and one of those causes can be identified as the proximate or dominant cause of the loss, it will be treated as the operative cause, and the person responsible for it will be responsible for the loss.*
>
> *In the third place, even if it cannot be said that events for which the employer is responsible are the dominant cause of the loss, it may be possible to apportion the loss between the causes for which the employer is responsible and other causes. In such a case, it is obviously necessary that the event or events for which the employer is responsible should be a material cause of the loss.*
>
> *[W]e are of opinion that apportionment will frequently be possible in such cases, according to the relative importance of the various causative events in producing the loss. Moreover, the alternative to such an approach … would deny him a remedy even if the conduct of the employer or the architect is plainly culpable…. It seems to us that in such cases the contractor should be able to recover for part of his loss and expense, and we are not persuaded that the practical difficulties of carrying out the exercise should prevent him from doing so.*

It is clear from these words that the Court of Session foresaw an apportionment of responsibility for the delay and thereafter an evaluation of the contractor's financial loss based on this apportionment. This being so, there is no reason why the same global approach should not be applied to the evaluation of extensions of time.

Lord Drummond Young went on to state:

> *"Where disruption to the contractor's work is involved, matters become more complex. Nevertheless, we are of the opinion that apportionment will frequently be possible in such cases…"*

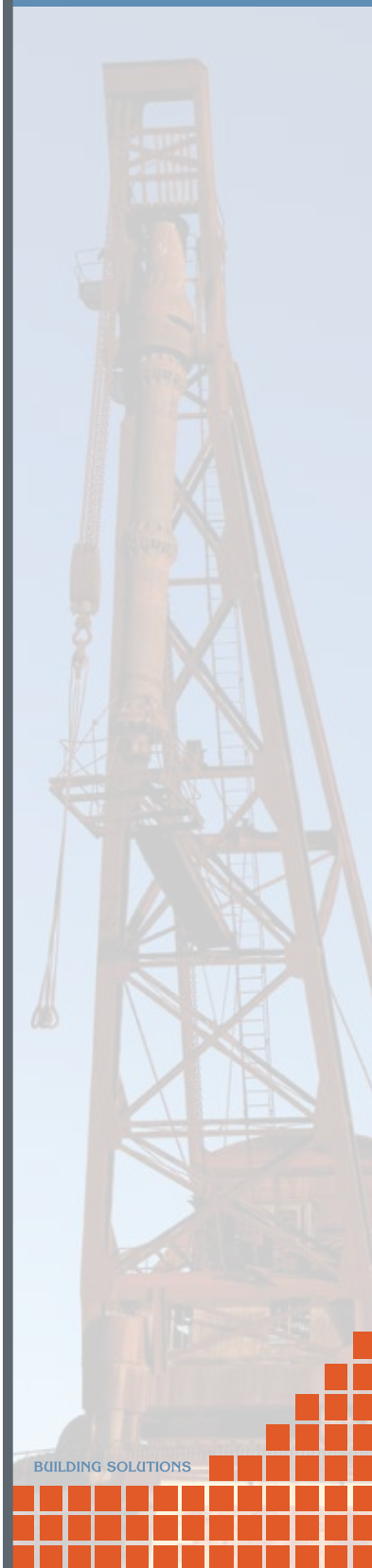
Lord Drummond Young acknowledged that:

> *"It may be said that such an approach produces a somewhat rough and ready result"*

but he went on to state that:

> *"This procedure does not, however, seem to us to be fundamentally different in nature from that used in relation to contributory negligence or contribution among joint wrongdoers.*

…continued on page 14



However, contractors should not view the decision as a ticket for a free meal! They are still required to set out the events relied on; to isolate as far as possible the consequences of individual events; to eliminate as far as possible the consequences of events that are not the responsibility of the employer; to set out in detail the heads of loss which cannot be accurately allocated to individual events; to set out the general proposition that links between the events and the losses do exist and to aver and establish that it is impossible or highly impracticable to identify the causative links between each event and the consequence thereof.

However, the Court of Session saw fit to reject an application for summary dismissal and to allow it to proceed to trial while indicating that the analysis should take into account the impracticality of proving causation by event on appropriate sub-portions of the claim if not the whole claim.

[The full article was published in The International Construction Law Review, Volume 22, Part 2, April 2005. The Scottish John Doyle case spawned the more famous series of City Inn cases. In England, however, the Technology and Construction Court considered the issue in Walter Lilly & Co Ltd [2012] EWHC 1773 (TCC); [2012] B.L.R. 503 and held that the principle of apportionment of the period of delay and partial EOT 'probably' does not reflect the law of England.]

FIRM NEWS

Honors

Best Lawyers In America 2017

The following Watt Tieder attorneys were named among the Best Lawyers in America for 2017: **John B. Tieder, Jr., Robert M. Fitzgerald, Lewis J. Baker, Carter B. Reid, Edward J. Parrot, Vivian Katsantonis, Kathleen O. Barnes** and **Robert C. Niesley**.

Best Lawyers is the oldest and most respected peer-review publication in the legal profession. A listing in **Best Lawyers** is widely regarded by both clients and legal professionals as a significant honor, conferred on a lawyer by his or her peers. The lists of outstanding attorneys are compiled by conducting exhaustive peer-review surveys in which tens of thousands of leading lawyers confidentially evaluate their professional peers.

Upcoming And Recent Events

CMAA National Conference & Trade Show, October 9-11, 2016; San Diego, CA; **David F. McPherson** was a panelist discussing "Developing Trends in Construction Claims and Disputes." **Christopher J. Brasco** and **Kathleen O. Barnes** spoke on "The Professional CM and Safety: A Conversation on Potential Liability Concerns" and "A Fresh Look at Productively Managing Lost Production."

Washington State Bar Association and Oregon State Bar Association Seminar, Two States of Construction Law: Working in Both Washington and Oregon, November 4, 2016; Vancouver, WA; **Diane C. Utz** spoke on Construction Changes and Notice Requirements: Comparison of Laws Between Washington and Oregon.

Risk Management in Underground Construction Conference, November 14, 2016; Miami, Florida; **Robert M. Fitzgerald** spoke.

Construction SuperConference, December 5-7; Las Vegas, NV; **Shelly L. Ewald** to speak on "Changing Trends in Government Contracts and Claims." **R. Miles Stanislaw** and **Christopher Wright** also will be participating in a panel session on December 7 entitled "How to Maximize the Benefits of Arbitration and Achieve Positive Results from the Process."

ABA Fidelity & Surety Law Committee's 2017 Midwinter Meeting, January 19, 2017; New Orleans, LA; **Adam M. Tuckman** to speak on "Differing Site Conditions on Federal Design-Build Projects." Paper authors: **Adam M. Tuckman** and **Stephanie M. Rochel**.

Watt Tieder Welcomes Three New Associates

Erica M. Del Aguila joins the Chicago, Illinois office. Erica focuses her practice in the areas of commercial litigation, construction, and suretyship. Erica has experience representing owners, contractors, subcontractors, and sureties in all aspects of private and public construction projects at both the state and federal levels.

Prior to joining **Watt Tieder**, Erica worked at a Chicago based law firm where she represented businesses and financial institutions in general commercial litigation matters, commercial financing transactions, entity formation, and enforcement of banking and creditors' rights.

Aniuska Rovaina also joins the Chicago, Illinois office. Aniuska focuses on commercial litigation, construction and suretyship, representing owners, contractors, subcontractors, and sureties in both the public and private context, providing a full range of transactional and litigation services to her clients.

Aniuska received her Juris Doctor from Chicago-Kent College of Law, where she was recognized as part of the Dean's List. She was a member of the school's trial advocacy team and competed in the National Civil Trial Competition. During law school, Aniuska did a judicial externship with the Honorable Judge Michael T. Mullen. Prior to law school, she worked at a commercial litigation firm in Detroit, Michigan.

George E. ("Trip") Stewart, III joins the McLean, Virginia office. Trip's practice focuses on government contracts, construction, and suretyship. He represents contractors, owners, subcontractors, and sureties in all types of construction litigation. He joins **Watt Tieder** as a first-year associate after having clerked for the firm as a summer associate.

In law school, Trip concentrated his studies in government contracts and was a member of the Public Contract Law Journal. He also interned for the Honorable Judge Marian Blank Horn of the United States Court of Federal Claims and for the Personal Property Division of the United States General Services Administration. During his third year of law school, he was a member of the Law Students in Court clinic and represented tenants before the Superior Court of the District of Columbia and the District of Columbia Office of Administrative Hearings. Prior to law school, he was an educator in Baltimore and taught middle school social studies.

Publications

George E. Stewart, III published an article in the Public Contract Law Journal entitled "Provisional and Forgotten: The Department of Homeland Security Should Take Steps to Receive Permanent Other Transactional Authority," 45 Pub. Cont. L.J. 715 (2016).

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Independent Law Firm

The Watt, Tieder, Hoffar & Fitzgerald newsletter is published quarterly and is designed to provide information on general legal issues that are of interest to our friends and clients. For specific questions and concerns, the advice of legal counsel should be obtained. Any opinions expressed herein are solely those of the individual author.

Special Thanks to Editors, **Robert G. Barbour, Keith C. Phillips, William Groscup** and **Heather Stangle**.

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