I. MECHANIC'S LIEN BASICS

The object and purpose of the Mechanics' Lien Act ("Act") is to protect those who, in good faith, furnish material or labor for the improvement of real property. The theory underlying the Act is that the owner is benefited by the improvements made to their property and should pay for that benefit when it has been induced or encouraged by the owners act. The Act permits a contractor to place a lien on property when the owner has received a benefit, and the furnishing of labor and materials have increased the value or improved the condition of the property. The Act attempts to balance the rights and duties of owners, contractors, subcontractors, and material providers. The burden of proving that each requisite of the Act has been satisfied is on the party seeking to enforce the lien.

The rights granted by the Mechanics Lien Act are creations of statute, not common law. A lien holder must therefore prove compliance with the Act's provisions to establish his right to the statutory remedy and cannot claim surprise when a defendant attempts to defeat his claim by proof of noncompliance. However, once the contractor or subcontractor has strictly complied with the requirements and the lien has properly attached, then the Act should be liberally construed to accomplish its remedial purpose.

Illinois Compiled Statutes 770 ILCS 60/1 governs Mechanic's Liens. Section 1 of the Act allows, anyone who contracts with the owner or with one whom the owner has authorized or knowingly permitted to contract for purposes of improving the land, to file a lien. It also permits the filing of a lien by those who contract to manage a structure under construction. Others who constitute a contractor capable of filing and enforcing a lien under the Act include general contractors, architects, engineers, land surveyors, structural engineers, professional engineers and project managers. In *LaSalle Bank National Association v. Cypress Creek*, the Illinois Supreme Court treated LaSalle Bank, a lender, as a lien holder by effectively subrogating it to the value of
improvements made to the subject property which were funded by LaSalle’s construction loan to the owner. The Illinois legislature, however, effectively nullified that ruling and passed House Bill 3636 which amended Section 16 of the Act. The amendment to Section 16, which became effective on February 11, 2013, impacts the distribution of sale proceeds when they are insufficient to satisfy the claims of both previous encumbrancers and lien creditors. The significant portion of the Amendment reads that “When the proceeds of a sale are insufficient to satisfy the claims of both previous encumbrancers and lien creditors, the proceeds of the sale shall be distributed as follows: (i) any previous encumbrancers shall have a paramount lien in the portion of the proceeds attributable to the value of the land at the time of making of the contract for improvements; and (ii) any lien creditors shall have a paramount lien in the portion of the proceeds attributable to the value of all subsequent improvements to the property.”

In an apparent effort to circumvent this new legislation, lenders began mandating subordination clauses in owner’s agreements with contractors which would subordinate lien rights to the lien of the mortgage. Not to be outdone, Illinois, in July of 2014, enacted Public Act 98-764 (Senate Bill 3023) further amending Sections 1 and 21 of the Act to restrict lenders from subordinating liens to only certain circumstances. Section 1(d) of the Act now allows an agreement to subordinate a mechanics lien to a mortgage lien securing a construction loan if that agreement is made after more than 50% of the loan has been disbursed to fund improvements to the property. As a result, a construction lender can now achieve the protection offered by a subordination of mechanics lien rights, but not until half or more of its construction loan proceeds have been disbursed. SB 3023 also amended Section 21(b) of the Act to provide that subcontractors may be subject to the subordination agreement if the contract between the contractor and subcontractor expressly provides for such subordination.

The Contractors. Original Contractor – An original contractor has a contract with the owner or with one whom the owner has authorized or knowingly permitted to contract to improve the property. Subcontractor – A subcontractor is one who contracts with the original contractor.

The Lien. There are four prerequisites for bringing a contractor's lien claim: (1) a valid contract; (2) with the owner of the property or his agent or someone who is knowingly permitted by the owner to contract for improvements; (3) for the furnishing of services or materials; and (4) performance of the contract or a valid excuse for nonperformance. A contractor who has met these prerequisites for bringing a claim for lien has merely acquired an inchoate right to a lien which must then be perfected in accordance with the requirements prescribed in the Mechanics Lien Act. A properly perfected mechanic’s lien claim relates back to the date of the contract.

A. Requirements

A claim for lien must: (1) be verified by the affidavit of the claimant, or his or her agent or employee; (2) shall consist of a brief statement of the claimant's contract, the balance due after allowing all credits; and (3) a sufficiently correct description of the lot, lots or tracts of land to identify the same. Such claim for lien may be filed at any time after the claimant’s contract is made, and as to the owner may be filed at any time after the contract is made and within 2 years after the completion of the contract, and as to such owner may be amended at any time before the final judgment.
B. Enforcement and Foreclosure

1. Contractors must record a claim for lien within 4 months of completion of the contract or within 4 months after furnishing any extra work or material thereunder. Contractors must also file suit to enforce the lien within 2 years after completion of the contract or within 2 years after furnishing any extra work or material thereunder. Contractors also have the option of filing suit within 4 months of contract completion. In order to have a valid lien, a contractor must have completed the lienable work within three years from the commencement of said work as to residential property; and within 5 years from the commencement of said work in the case of work done as to any other type of property.

2. Subcontractors must serve a written notice, on the owner – or its agent and on any mortgagees of record, notifying it of any work performed or to be performed on the property and the amount due or to become due thereunder, within 90 days after completion of the work. The subcontractor must also file a claim for lien within four months of the last date of work performed and file suit within 2 years of that same date. Service of the 90-day notice is a condition precedent to the creation of the lien, so that no lien attaches when the owner does not receive timely written notice.

   a. 60-day Exception for Single Family Residence. The exception to this for subcontractors comes into play when work is being performed on an existing owner occupied single family residence. In that instance, notice must be given to the occupant within 60 days from the time that it first furnishes labor. The notice shall contain the name and address of the subcontractor or material man, the date he started to work or to deliver materials, the type of work done and to be done or the type of materials delivered and to be delivered, and the name of the contractor requesting the work. The notice shall also contain the following warning in at least 10 point bold face type:

   “NOTICE TO OWNER - The subcontractor providing this notice has performed work for or delivered material to your home improvement contractor. These services or materials are being used in the improvements to your residence and entitle the subcontractor to file a lien against your residence if the services or materials are not paid for by your home improvement contractor. A lien waiver will be provided to your contractor when the subcontractor is paid, and you are urged to request this waiver from your contractor when paying for your home improvements.”

   Such warning shall be by certified mail and will be considered served at the time of its mailing.

3. Lien Foreclosure. If payment is not made to the contractor having a lien by virtue of this Act of any amount when it becomes due, then the contractor may bring suit to enforce his lien in the circuit court in the county where the property is located, as long as he does so within 2 years after contract completion. Any two or more persons having liens on the same property may join in bringing a suit, setting forth their respective rights in their complaint.
a. **Notice of Foreclosure.** A notice of foreclosure, whether the foreclosure is initiated by complaint or counterclaim, made in accordance with The Act and recorded in the county in which the mortgaged real estate is located shall be constructive notice of the pendency of the foreclosure to every person claiming an interest in or lien on the mortgaged real estate, whose interest or lien has not been recorded prior to the recording of such notice of foreclosure. (*Lis Pendens*).

4. **Liens Against Public Funds.** Any person who shall furnish labor, services, material, fixtures, apparatus or machinery, forms or form work to any contractor having a contract for public improvement for any county, township, school district, city, municipality, municipal corporation, or any other unit of local government in this State, shall have a lien for the value thereof on the money, bonds, or warrants due or to become due the contractor having a contract. No person shall have a lien as provided herein unless such person shall, before payment or delivery thereof is made to such contractor, notify the clerk or secretary, as the case may be, of the public entity by written notice of the claim for lien. The notice must contain a sworn statement identifying the claimant’s contract, describing the work done by the claimant, and stating the total amount due and unpaid as of the date of the notice for the work and furnish a copy of said notice at once to said contractor. Upon written demand from the contractor, the lien holder shall, within 30 days, notify the clerk or secretary of the public entity of his claim for a lien in the same manner provided for above. Failure to do so will result in forfeiture of the lien.

The person claiming the lien against the public entity shall, within 90 days after serving such notice, commence proceedings by complaint for an accounting. In filing such a suit, the claimant must name, as a party defendant, the contractor who had a contract with the unit of local government and the contractor to whom such services and material was furnished. Within ten days after filing the complaint, the claimant must notify the clerk or secretary of the public entity of the commencement of such suit by delivering to him or them a copy of the complaint filed. Failure to abide by these guidelines shall terminate the lien and result in forfeiture thereof.

5. **Substitution of Bond for Lien.** In July of 2015, Illinois House Bill 2635 was enacted by the Illinois legislature adding Section 38.1 to the Mechanics Lien Act. This new section offers a process by which an owner, other lien claimant or other person having an interest in the property may file a petition to substitute a bond for the property subject to a lien claim. The concept behind this process is to remove the mechanics lien as an encumbrance to the real property and to allow the construction project to move forward. This legislation became effective January 1, 2016.

In order for the bond to replace the original lien claim, a verified petition must be filed with the circuit clerk of the court where the property is located and be approved by a court of competent jurisdiction after notice is given to the lien claimant. The verified petition must be filed within 5 months of the filing of a complaint or counterclaim to enforce the subject lien claim. In the event of a pre-suit lien, there is no time limitation to the filing of the verified petition. The proposed bond must be attached to the verified petition and be in an amount equal
to or greater than 175% of the total value of the lien claim. Upon receipt of service of the petition, the lien claimant has 30 days to file any objection thereto.

The principal and surety of the surety bond shall be jointly and severally liable to the lien claimant for the amount that the lien claimant would have been entitled to recover under the Act if no surety bond had been furnished, subject to the limitation of liability of the surety to the face value of the bond. In addition, the prevailing party in an action brought under this section of the Act shall be awarded its reasonable attorney’s fees. The attorney’s fees for a lien claimant that is a prevailing party shall be limited to the amount remaining on the bond after the payment of the claim and interest. The attorney’s fees awarded to a bond principal shall be limited to 50% of the amount of the lien claim.

6. Attorneys’ Fees. In addition to Section 38.1 above, the Act allows recovery of fees in rare cases where a court finds that the owner who contracted to have the improvements made failed to pay any lien claimant the full contract price, including extras, without just cause or right. Recovery of fees is only allowed for lien claimants who had perfected and proven their claims. Lien claimants who bring an action under this Act without just cause or right may also be taxed with paying the reasonable attorney’s fees of the owner who contracted to have the improvements made and defended the action, but not those of any other party. “Without just cause or right”, as used in this Section, means a claim asserted by a lien claimant or a defense asserted by the owner who contracted to have the improvements made, which is not well grounded in fact and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law. Although rare, Illinois Courts have recently ordered the payment of substantial fees under the Act.

C. Ability to Waive and Limitations on Lien Rights

Section 34 and 35 of The Act provide a procedure by which the owner of land can demand commencement of suit within 30 days. If a suit to enforce the lien is not commenced by the lien holder within 30 days, and the lien is not released upon subsequent demand, an owner can file suit to extinguish the lien. Failure to commence suit and/or release the lien after demand by the owner could subject the lien holder to financial liability of $2,500 plus fees. When an owner of real estate sends a written demand pursuant to Section 34 of the Act, the owner making the demand is required to include the following language in at least 10 point bold face type: “Failure to respond to this notice within 30 days after receipt, as required by Section 34 of the Mechanics Lien Act, shall result in the forfeiture of the referenced lien.” Section 34 of the Act was recently amended to allow a County Recorder to issue a notice under this section to reduce the existence of expired liens on properties.

Due to an increasing problem with expired liens on residential properties as noted above, Illinois House Bill 5201 was enacted in August 2018 allowing a County’s Code Hearing Unit to adjudicate the validity of a mechanic’s lien. Under newly enacted Section 34.5 of the Act, upon notice from the county Recorder and clear and convincing evidence that a lien is expired, an Administrative Law Judge now has the power to rule an expired lien to be forfeited and thus no longer affecting the chain of title of the property.
As an owner of property, you should never pay a contractor for services rendered thereon prior to receiving a sworn statement pursuant to section 5 of the Act. Section 5 of The Act requires Contractors to issue a sworn statement to the owner listing names and addresses of all parties furnishing materials and labor and the amounts due or to become due to each. 40

II. PUBLIC PROJECT CLAIMS

In Illinois there are two typical avenues to make claims on public projects. First, a subcontractor or materialman may file a lawsuit against the required construction bond. Second, a subcontractor or materialman may file a lien under the Illinois Mechanics Lien Act section applicable to public entities.

A. State and Local Public Work

The Illinois Public Construction Bond Act requires a bond for construction projects. Each public bond is deemed to have payment and completion guarantees written into the bond. 41

Specifically, bonds must be obtained for public work costing over $50,000 for the State, or any political subdivision thereof. 42 For contracts under $100,000, the public entity may permit the general contractor to provide an irrevocable bank letter of credit, in lieu of a bond. 43 The general contractor is the entity that obtains the bond. The amount of bond is not fixed by statute. Rather is set by the public entity letting the work. 44

The public body may also recover under the bond for nonperformance by the general contractor. The Public Construction Bond Act provides requirements and deadlines for the surety to respond when the general contractor does not perform under the contract. 45

1. Notices and Enforcement.

Under the Public Construction Bond Act, a person furnishing material or performing labor for a State or political subdivision of the State may bring an action on the bond. The claimant must first file a verified notice of claim within 180 days after the date of the last item of work and furnish a copy of the verified notice to the general contractor within 10 days of filing the verified statement.

After the verified notice of claim is perfected, an action at law may be filed on the bond. The action must be brought in the circuit court for the county where the contract is to be performed. The action must be brought in the name of the State or political subdivision thereof for the use and benefit of the Claimant (subcontractor or person furnishing material). No action under the bond may be brought later than one year after the date of the furnishing of the last item of work or materials by the claimant. 46

B. Claims to Public Funds

Illinois permits subcontractors and materialmen to make claims on public funds under the Illinois Mechanics Lien Act. 47 It should be noted that a lien on public property is a remedy available for subcontractors and is a lien on the funds to become due to the general contractor.
The lien does not attach to real property owned by the State or local government.48

The general contractor does not have a right to lien against the public funds. Rather, the general contractor must rely on its contractual rights if the general contractor has claims against the public entity. Typically the general contractor’s remedy against the public entity is a claim for breach of contract.

1. Notices and Enforcement.

Notices of mechanics liens and enforcement of the lien against public entities is governed by 770 ILCS 60/23. The notification procedure differs for state and local government contracts under Illinois law. The statute sets forth the procedure that must be followed and includes lien notification deadlines, as well as specific entities or persons that must be notified of the lien. Failure to comply with the statute will result in a waiver of the lien.

In general terms the notice of mechanics lien must contain a sworn statement identifying the claimant’s contract, describing the work done by the claimant, and stating the total amount due and unpaid for the work as of the date of the notice. The notice of lien must be served on general contractor and public entity. In order to perfect a lien against public funds, (1) a notice of lien must be served upon the public entity and the general contractor; (2) at a time when it is in possession of funds or due or to become due to the general contractor; and (3) such funds have not been allocated for another construction project or another portion of the same project.49

On public projects a procedure exists for the general contractor to demand that a subcontractor or materialman assert a lien. This demand starts a 30 day clock on liens by that subcontractor or materialman. If no lien is served within the 30 days, then it is forfeited.50

After a public entity receives the notice of lien the public entity must immediately withhold an amount sufficient to cover the lien from the general contractor to pay the claim. 51

A lien must first be served before an accounting lawsuit may be filed. The mechanics lien act requires that proceedings for an accounting must be commenced within 90 days after serving notice of the lien.52 Failure to comply with the 90 day deadline results in a waiver of the lien.

A complaint for an accounting is the proper mechanism to enforce a mechanics lien on a public construction project. The claimant is named as the plaintiff and the contractor having the contract with the public entity is named as the defendant. The public entity must receive a copy of the complaint within 10 days after it is filed.53 Venue for such an action exists in the county where the public entity is located or the county in which the transaction at issue occurred.54

III. STATUTES OF LIMITATION AND REPOSE

The Illinois Code of Civil Procedure contains both a statute of limitations and a statute of repose for construction claims.55
A. Statutes of Limitation and Limitations on Application of Statutes

A construction claim includes actions based upon tort, contract or otherwise for an act or omission in the design, planning, supervision, observation or management of construction. An action must be commenced within 4 years from the time the plaintiff knew or should reasonably have known of the act or omission.

The discovery rule requires the injured party to make further inquiry into the injury and its causes to determine whether actionable conduct is involved. Where there are both actionable and non-actionable explanations for an injury, the determination of whether the information available to the claimant was sufficient to meet the knowledge requirement is left to the trier of fact.56

Personal injuries related to construction are subject to the four-year statute of limitations for construction claims rather than the general two-year statute of limitations for personal injuries.57 But a claim for contribution or indemnity must be filed within two years after the party seeking such relief knew or should have known of the act or omission giving rise to the action for contribution or indemnity, but in no event later that two years after the party seeking such relief has been served with process in the underlying action.58

B. Statutes of Repose and Limitations on Application of Statutes

No action can be brought after ten years from the act or omission. However, if discovery of the act or omission is made within 10 years from the date of the act or omission, the plaintiff shall in no event have less than 4 years to bring the action from the date of discovery. The statute also contains exceptions for minors, plaintiffs with disabilities, and cases involving fraudulent misrepresentation or concealment.

Actions against property owners premised on defendants’ capacity as a property owner rather than a party engaged in construction related activity fall outside the scope of the construction statute of repose.59 Furthermore even though a party receives the protection of a statute of repose for activity that falls within the purview of the statute, it does not receive protection for other activities outside of that purview.60

IV. PRE-SUIT NOTICE OF CLAIM AND OPPORTUNITY TO CURE

The legal rights of the parties involved in a construction dispute are determined primarily by the terms of the contract into which they have entered. Two areas of contention that often arise are whether one party’s breach of the contract discharges the other party from performing its own contractual obligations and under what circumstances an owner may rightfully terminate the contractor.
While a party may subject itself to liability by failing to perform its contractual duties, only a material breach of the contract’s terms will serve to excuse the other party from performing its own obligations under the contract. The determination of materiality is a question of fact involving an inquiry into the intent of the parties with respect to the disputed provisions as well as the equitable factors and circumstances surrounding the alleged breach.

Termination of a contractor must also be predicated on a material breach of the contract. The grounds and procedure for termination are dictated by the contract. The American Institute of Architects publishes the most widely used set of construction contracts in the industry. Pursuant to the AIA documents, two steps are required to justify termination under the contract. First, the architect must certify to the owner that sufficient cause exists to justify termination under the contract. Second, the owner may be required to serve several written notices of termination on the contractor and the surety. The contractor then must be given the opportunity to cure the defect within the time period specified in the contract, and the owner cannot obstruct, interfere, or otherwise impair the contractor’s ability to correct the defect. The compliance or violations of the notice and cure provisions will then determine the rights and obligations of the respective parties.

The growing national trend towards expansion of construction defect litigation has prompted some states to pass some version of a “right to repair” or “notice and opportunity” law. While these statutes vary from state to state, they typically allow for dismissal of a homeowner’s action if the homeowner has not provided the contractor with notice of the alleged defect, an opportunity to inspect the premises, and an opportunity to correct the defect or settle the claim. The American Legislative Exchange Council (ALEC) has drafted model legislation in this area.

Over the years similar legislation has been proposed in Illinois, but has not been enacted into law. House Bill 4873 which would have created the “Notice and Opportunity to Repair Act” was introduced in the 94th General Assembly (2005/2006), but was not enacted. More recently House Bill 1114, which would have created the “Notice and Opportunity to Repair Act,” was introduced in the 95th General Assembly (2007/2008), given a first reading and assigned to the Illinois House Judiciary I-Civil Law Committee and twice to the Rules Committee for further hearings, but was ultimately not enacted. The status of any proposed legislation may be monitored on the General Assembly website. Should this, or similar legislation be reintroduced and become law, Illinois would require notice to the construction professional of a complained of defect in the construction by the homeowner prior to the commencement of a construction defect lawsuit. The construction professional would then be given a period of time to inspect the alleged defect and/or dispute the claim or make an offer of repair or settlement. The satisfaction or violation of this provision and others would then dictate the respective rights and obligations of the parties to the dispute.

At this time there is no similar legislation pending in the 100th (2017-2018) Illinois General Assembly.
V. INSURANCE COVERAGE AND ALLOCATION ISSUES

A. General Coverage Issues

A standard Commercial General Liability ("CGL") policy typically provides coverage for those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which the insurance applies. The insurance typically applies to "bodily injury" and "property damage" if: (1) the "bodily injury" or "property damage" is caused by an "occurrence" that takes place within the covered territory; and (2) the "bodily injury" or "property damage" occurs during the policy period.

Further, typical policy exclusions exclude from property damage coverage, damage to your "product" or damage to "your work." Your work includes "work or operations performed by you or on your behalf and materials, parts or equipment furnished in connection with such work and operations."

B. Trigger of Coverage

Under Illinois law, the aforementioned exclusions have been interpreted to indicate that GL policies are not intended to provide protection against an insured's own faulty workmanship or product, which are normal risks associated with the conduct of the insured's business. A liability insurance policy is not intended to become a warranty or converted into a performance bond.

With regards to triggering coverage, the use of the term "occurrence" instead of "accident" in insurance policies broadens coverage and eliminates the need to find an exact cause of the damages, so long as the damages are neither expected nor intended (that is, are accidental) from the standpoint of the insured. An accident under Illinois law is defined as "an unforeseen occurrence, usually of an untoward or disastrous character, or an undefined sudden or unexpected event of an inflictive or unfortunate character." Property damage to a building caused by a contractor's defective construction of the building is not an accident and does not, therefore, constitute an "occurrence" under the CGL policy at issue.

Accordingly, when a property damage case arises, it is imperative that a determination be made as to whether there has been an occurrence and whether there is property damage covered under the subject policy.

C. Allocation Among Insurers / Issues with Additional Insurance

Under the case of John Burns Construction Co. v. Indiana Ins. Co., the Illinois Supreme Court recognized that an insured who is named as an additional insured on multiple insurance policies can select which policy or policies they wish to invoke coverage under to the exclusion of other policies on which they are named as an insured, thus allowing a "targeted tender."
Accordingly, a contractor can tender the defense and insurance obligation to another contractor's insurance company if said contractor has been named as an additional insured. That insurer is then required to pick up the defense exclusively, and is not allowed to invoke any of the contractor's own insurance coverage to defend or indemnify the contractor in litigation.

Further, under what has been termed the "horizontal exhaustion rule," a contractor named as an additional insured on multiple policies has the right to stack the primary policies of coverage in the order it deems appropriate. However, Illinois does not allow a contractor with multiple primary and excess policies to target an excess policy to respond prior to all primary policies being exhausted.

In the case of North River Ins. Co. v. Grinnell Mutual Reinsurance Co., the Illinois Appellate Court recognized that one that has multiple excess policies can target tender those excess policies and dictate the order of response after all applicable primary policies have been exhausted.

VI. CONTRACTUAL INDEMNIFICATION

Illinois courts do not recognize indemnity agreements in construction contracts. Attempts at indemnification as among parties set forth in contracts for construction work are void in violation of the Illinois Construction Contract for Negligence Act, more commonly known as the Illinois Anti-Indemnity Act. However, at the present time, having contract provisions that agree to provide insurance coverage for another party are acceptable and enforceable. See above.

Because almost all construction contracts, including AIA contracts, continue to contain indemnity provisions, Illinois courts have stated that these clauses were intended to bind the parties to unlimited contribution as among one another, and to act as a waiver on any potential cap on damages that might be afforded an employer by way of the Illinois Worker's Compensation Act and Kotecki v. Cyclops Welding Corp. The seminal Illinois Supreme Court cases on this topic are Braye v. Archer-Daniel-Midland Co. and Liccardi v. Stolt Terminals.

Thus, the indemnity language in a typical construction contract can expose an employer to unlimited contribution to the full extent that an employer is responsible for causing or contributing to cause an accident to his employee, without regard to the amount of money it has paid in worker's compensation benefits to that employee. These provisions have also been interpreted as valid agreements to provide defenses for parties in litigation. These indemnity agreements are often looked to in cases where an insurer has failed to assume a defense pursuant to a tender of defense, or to provide adequate coverage for protection of a named defendant. Accordingly, when a subcontractor employee sues another contractor, that contractor often files a contribution claim against the employer for unlimited contribution therein seeking to have the indemnification agreement contained within their contract interpreted as an express agreement to waive any limitation on the right of contribution against the employer.
Illinois courts have struggled to determine what insurance policy, if any, covers the employer’s exposure over and above its workers compensation lien in situations where the employer waives its cap on contribution through an indemnity provision. In *Virginia Surety v. Northern Insurance Co.*, the Illinois Supreme Court interpreted a standard commercial general liability policy as well as a standard indemnity provision and held that the employer’s CGL carrier did not owe a duty to defend or indemnify the employer for its exposure above its workers compensation lien.81

**VII. CONTINGENT PAYMENT AGREEMENTS**

Contingent Payment Agreements, also known as “Pay-When-Paid” Agreements, are enforceable in Illinois.82 However, they are the type of condition precedent Courts frown upon, and therefore will be looked at with scrutiny when challenged.

**A. Enforceability**

As indicated above, Illinois courts do recognize Pay-When-Paid provisions. Paid-When-Paid provisions are interpreted like all contract provisions in Illinois, and in determining the meaning of the contract, especially with respect to Pay-When-Paid provisions, a court must make every effort to effectuate the intentions of the parties.83 A court must arrive at meaning from language used in the contracts and if language in the contracts is clear and unambiguous no evidence outside of the contract itself may be considered in determining the contract’s meaning.84

Construction of contractual terms is a pure question of law, and one need only look to the principles of construction and the contract itself to resolve disputes.85

However, it is also well documented under Illinois law that conditions precedent in contracts are not favored by the courts, and contracts will not be construed as having condition precedents unless required to do so by plain, unambiguous language.86

**B. Requirements**

Although Pay-When-Paid clauses are enforceable, and particularly, will be enforced if clear and unambiguous, it is equally true that the performance of a condition precedent is excused if the party for whose benefit the condition is created prevents the condition from occurring.87 For example, where a contractor by its own fault has lost the right to payment from the owner, a subcontractor is entitled to compensation from that contractor. Further, the party for whose benefit a condition precedent runs must “use reasonable efforts to have it occur.”88 In the *Marino* case, Marino entered into a contract with a local Village whereby Marino agreed to construct a 4,000,000 gallon water storage reservoir. Marino hired Preload as a subcontractor. Preload agreed to furnish the pre-stressed concrete. Preload completed its work and submitted requests for payment. Marino refused to pay contending that it had not yet been paid by the Village. However, the Village’s refusal to pay Marino was based upon the Village suing Marino for breach of contract. Further, the contract between the Village and Marino authorized the Village to recover liquidated damage for said breach and to refuse payment where it was entitled to a set off.89 Wherefore, the United States District Court for the Northern District of Illinois,
Eastern Division, held that Marino could not refuse payment to Preload based upon the “Pay-When-Paid” provision in its contract, where Marino itself had caused the failure of the Village to pay it.

The case of Brown and Kerr, Incorporated v. St. Paul Fire & Marine Ins. Co., cautioned that a surety cannot rely upon a subcontract agreement Pay-When-Paid clause to refuse payment on the surety bond, where the surety agreement does not incorporate the payment terms of the subcontract, nor include its own condition precedent to payment. The bond agreement and the subcontract agreement are two separate agreements and will be determined separately.

Finally, the case of DeGraff Bros. Inc. v. Mellon Stuart Co., the court found a Pay-When-Paid clause ambiguous and unenforceable, where the terms of the Pay-When-Paid clause did not dictate whether payment to subcontractors would come from the first installment payment it received, or only after the last, or based upon a pro rata share of the payments received.

In the DeGraff case, DeGraff brought an action against Mellon Stuart based upon a contract to perform work as a subcontractor to Mellon Stuart, the general. Mellon Stuart argued that it was not allocated to pay DeGraff’s balance out of the first installment it received from the owner, but rather, because it had not received full payment for all of the work performed by its subcontractors, Mellon Stuart argued that the only equitable method for dividing the payments it received among its subcontractors was on a pro rata basis.

The DeGraff court found that the subcontract was ambiguous as to whether DeGraff was to receive its final payment out of the first installment, or to receive partial payments out of each installment and was unable to find any contingency provision within the contract to cover this situation. They, therefore, held that the contract was ambiguous, and reserved that question to be determined at trial.

C. Conclusion

Although Pay-When-Paid clauses are enforceable, they are not favored, and as such, must be clear and unambiguous in order to assure enforcement of the terms intended.

VIII. SCOPE OF DAMAGE RECOVERY

Where a contract has been breached, recoverable damages are those which (1) naturally result from the breach, or (2) are the consequence of special or unusual circumstances which were within the reasonable contemplation of the parties when making the contract.
A. Personal Injury Damages v. Construction Defect Damages

If a plaintiff suffers a personal injury, he may be entitled to seek recovery for damages of conscious pain and suffering, loss of earnings, medical expenses, physical disability, and property damage.95 In determining damages the jury may consider the nature, extent and duration of the injury.96

When a construction error or defect creates a need to repair or replace a portion or all of a constructed project, courts typically apply the “cost rule,” which seeks to put the owner in the position that he would have occupied but for the error by compensating him for the cost of repair or replacement.97 However, if the cost to repair or replace is disproportionate to the value of the building or otherwise excessive, the measure of damages will likely be the diminution in value of the property as a whole which was caused by the defect.98

B. Attorney’s Fees Shifting and Limitations on Recovery

Attorneys’ fees are not recoverable unless specifically authorized by statute or contract.99 Provisions for attorneys’ fees are enforced at the discretion of the trial court, and the party requesting the fees bears the burden of providing evidence from which the circuit court can make a decision regarding the reasonableness of the fees.100 The court is required to strictly construe a contractual provision for attorney fees.101 If the contract does not specifically state the term “attorneys’ fees” within it by name, the court will not allow recovery therefor.102

C. Consequential Damages

Consequential damages may be recoverable in claims for a construction defect if they were within the contemplation of the parties at the time that the contract was entered into.103 These may include excess costs, loss of use, costs to settle with owner for subcontractor’s breach, or even lost profits or market share if proved with reasonable certainty.

D. Delay and Disruption Damages

A contractor or subcontractor may recover delay damages where the owner or contractor fails to prepare the property for work in a timely manner. The plaintiff must prove with reasonable certainty that its loss was caused by the delay and the amount of damages suffered.104

A contractor may recover increased-cost-of-performance damages resulting from delay caused by the contractee in the absence of a contractual provision to the contrary.105 Depending on the facts of the case, the court may apply the “total cost” method, which compares the total cost of performing the work with the amount the contractor originally estimated would be required for the project, or the “discrete” method, which considers at the damages due to the delay of specific items of work or periods of low work productivity.106
E. Economic Loss Doctrine

The economic loss doctrine in Illinois precludes an owner from recovering on a negligence theory in its construction claim unless personal injury or damage to property not contemplated by the construction contract occurred as a result of the negligence alleged.107

F. Interest

Contractors may be allowed to receive pre-judgment interest at the rate of five percent per annum for all moneys after they become due if withheld by an unreasonable and vexatious delay of payment108. Interest is not awarded on money that may be found due, if the person withholding payment has done so in good faith, because of a genuine and reasonable dispute. In other words, interest would be a proper element of recovery only if it could be said a relationship of debtor and creditor existed between the parties.

The Illinois Interest on Judgments statute provides in part that judgments recovered in any court shall draw interest at the rate of 9% per annum from the date of the judgment until satisfied.

G. Punitive Damages

Punitive damages are generally not recoverable for breach of contract unless the breach amounts to an independent tort which involves the requisite allegations and proof of malice, wantonness, or oppression.109 “Willful and wanton” is a tort concept that applies only to reckless or intentionally tortious conduct that causes physical harm to a person or property, it has no application to a non-tort claim such as a routine breach of contract action.110

H. Liquidated Damages

Damages may not be recovered in an action for breach of contract if the purpose of those damages is merely to secure a party’s performance of the agreement. Such damages are considered an unenforceable penalty unless the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach and that harm is difficult or impossible to estimate111. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty112. Although it is a general rule that, for reasons of public policy, a liquidated damages clause which operates as a penalty for nonperformance or as a threat to secure performance will not be enforced, it is not hardened fast113. Three elements that must be met in order to validate a liquidated damages clause are: (1) the parties intended to agree in advance to the settlement of damages that might arise from the breach; (2) the amount of liquidated damages was reasonable at the time of contracting, bearing some relation to the damages which might be sustained; and (3) actual damages would be uncertain in amount and difficult to prove114. There is no fixed rule applicable to all liquidated-damages agreements, and each one must be evaluated on its own facts and circumstances115.
I. Other Damage Limitations

Most construction contracts today contain liability limiting provisions which would apply to various circumstances. For example, a Time-Is-Of-The-Essence Clause, a Damages-For-Delay-Clause, or a No-Damages-For-Delay-Clause operates to protect a party in the event of nonperformance, such as unforeseen circumstances or impractical occurrences. These provisions are strictly construed, and Illinois courts may recognize exceptions to them where the contractee is not acting in good faith, the delay is not within the contemplation of the parties, the delay is of unreasonable duration, or the delay is attributable to inexcusable ignorance or incompetence.116

IX. CASE LAW AND LEGISLATION UPDATE

Carney v. Union Pacific Railroad

A recent Illinois Supreme Court Decision provides further analysis on the liability imposed on the employer of an independent contractor. Carney117 further explores liability under Section 414 of the Restatement of Torts. The Carney case holds that under 414 an employer of an independent contractor can only be held directly liable for the negligence of its employees and not vicariously liable for the negligence of the independent contractor.

In Carney, Union Pacific Railroad entered into an agreement with Happ to buy and remove three railroad bridges. Pursuant to the agreement, Happ agreed to provide all labor, tools and material necessary for the bridge removal work. Happ retained the plaintiff's father and the plaintiff to assist in the bridge removal work. During the work when removing steel girders from one of the bridges, the girder became stuck and additional cuts were needed. When the additional cuts were made, a girder fell on the plaintiff severing both of his legs. Plaintiff subsequently filed a complaint against Happ and Union Pacific. Numerous third party complaints were filed and everything was settled except for the claim by the plaintiff against Union Pacific Railroad. Defendant filed a motion for summary judgment which was granted and the plaintiff appealed. The Appellate Court reversed the granting of summary judgement. In reversing, the Appellate Court held "although an employer is typically not liable for the acts of an independent contractor, an exception exists where the employer retains the control over any part of the work, and that a genuine issue of material fact exists as to whether defendant retained such control over the work performed by Happ to become vicariously and directly liable."

The Illinois Supreme Court reversed the Appellate Court and affirmed the summary judgment entered by the trial court. The Illinois Supreme Court held, "The rule set forth in section 414 articulates a basis only for direct liability." An employer of an independent contractor is generally not responsible for the contractor's negligence and therefore, the employer's liability must be based on its own negligence. Section A of 414 states, "if an employer of an independent contractor retains control over the operative details of any part of the work he is subject to liability of the negligence of the employees of the contractor engaged therein, under Agency Law which deals with master servant." The court held that this sentence does not explain when section 414 applies, rather it explains when section 414 does not apply. If the level of control is to the extent that it gives rise to a master servant relationship the contractor's role as an independent contractor is no longer. An employer's liability for the
contractor's employees’ negligence under Agency Law is distinct from the principles illustrated under section 414 under which an employer is directly liable for its own negligence. The court concluded that section 414 takes over when Agency Law ends.

The court went on to analyze if the defendant retained control of the work. The court held that the best indicator of whether control was retained is the written contract between the employer and independent contractor. The contract specifically refers to Happ as an independent contractor and requires Happ to provide all supervision along with the all labor, tools and equipment needed for the job. The contract did not provide any control of the work. Even if the contract does not provide any retention of control of the work such control could be demonstrated by defendant's conduct. The testimony of the workers at the job site demonstrated that the defendant did not retain control over the work. Several witnesses testified that they did not receive any instruction from the defendant and all instruction was received from Happ and or Carney. Additionally, defendant’s conduct post-accident did not illustrate any retention of control over the remaining work. In fact, the testimony was clear that the plaintiff and his co-workers did not even speak with employees of the defendant about the work. The court held that the record contained no evidence that the defendant retained at least some control over the manner in which Happ performed the bridge removal work and therefore the trial court did not err in granting summary judgement.

Typically, an owner or general contractor will hire an independent contractor to perform work on a job site. The Carney case is an important case for owners and general contractors in defense of construction accidents. Pursuant to Carney, vicarious liability is no longer imposed under section 414 and only pursuant to Agency Law. Additionally, Carney further illustrates the need for an owner or general contractor to retain control over the means and methods of the work in order to be held directly liable for its negligence. Absent any control, owners and general contractors should be granted summary judgment.
Section 24 does not, however, require a subcontractor to serve notice of its claim on the owner when the sworn statement of the contractor or subcontractor provided for herein shall serve to give notice of the amount due and to whom due. 770 ILCS 60/24 (2004); Weather-Tite, Inc. v. Univ. of St. Francis, 233 Ill. 2d 385; 909 N.E.2d 830 (2009).

770 ILCS 60/21(c).
770 ILCS 60/23(b).
Id.
Id.
770 ILCS 60/23(b)(2).
770 ILCS 60/23(b)(4).
Id.
Id.
770 ILCS 60/23(b)(5).
770 ILCS 60/38.1.
24 770 ILCS 60/38.1(c)
Id.
770 ILCS 60/38.1(a)(2)(c)
770 ILCS 60/38.1(f)
770 ILCS 60/38.1(i)
Id.
Id.
Id.
770 ILCS 60/17(b)
770 ILCS 60/17(c)
770 ILCS 60/17(d)
Walter Daniels Construction Co. v. Dundee Reger LLC, 2016 IL App (1st) 151112-U.
770 ILCS 60/34-35.
770 ILCS 60/34.
Id.
770 ILCS 60/34.5
770 ILCS 60/5.
30 ILCS 550/1.
30 ILCS 550/1.
30 ILCS 550/1.
30 ILCS 550/1.
30 ILCS 550/2.
770 ILCS 60/23.
West Chicago Park Com’rs v. Western Granite Co., 200 Ill. 527 (1902); McMillan v. Joseph P. Casey Co., 311 Ill. 584 (1924).
770 ILCS 60/23; Board of Library Trustees v. Cinco Constr., 276 Ill. App. 3d 417, 422 (1st Dist. 1995).

770 ILCS 60/23(b)(2).

770 ILCS 60/23(b)(6),(c)(6).

770 ILCS 60/23(b)(5).

770 ILCS 60/23(b)(4),(c)(4).


735 ILCS 5/13-214.


735 ILCS 5/13-204.

Ambrosia Land v. Peabody Coal Co., 521 F.3d 778 (7th Cir. 2008).


Id.

Id.

See Bill Status at http://www.ilga.gov/legislation/.

Illinois HB 1114, 95th General Assembly.

Id.


Monticello v. Wil-Fred's Construction, 277 Ill. App. 3d 697, 661 N.E.2d 415 (1996). See also, Stoneridge Development Company, Inc. v. Essex Ins. Co., 382 Ill. App. 3d 731, 888 N.E.2d 633 (2008) where the court held that cracks that developed in a home were not an occurrence, nor would they be considered property damage, because the damage was the natural and ordinary consequence of improper construction methods and would not fall within the coverage of the CGL policy.


See Kajima Construction Services, Inc. v. St. Paul Fire & Marine Ins. Co., 227 Ill. 2d 102, 879 N.E.2d 305 (2007)(where the Illinois Supreme Court again held that an insured with multiple insurance policies covering any given loss has the right to select and/or deselect those policies that it wants to provide coverage under a factual scenario).

Id.


740 ILCS 35/1.


Id. citing National Aircraft Policing Ltd. v. American Airlines, Inc., 74 Ill. App. 3d 1014, 1020, 394 N.E.2d 470, 475 (1979); see also Beal Bank Nevada v. Northshore Center THC, LLC, 2016 IL App (1st) 151697, ¶ 14, 64 N.E.3d 201.


See Beal Bank Nevada v. Northshore Center THC, LLC, 2016 IL App (1st) 151697, ¶ 16, 64 N.E.3d 201; see also


88 Id. citing Dodson v. Nink, 72 Ill. App. 3d 51, 390 N.E.2d 546 (2nd Dist. 1979).

89 Id.


91 Id.


93 Id.


95 Murphy v. Martin Oil Co., 56 Ill.2d 423 (1974).


103 Edward E. Gillen (supra), 221 Ill. App. 3d 5.


106 Id.


114 Id.

115 Id.
