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A periodic bulletin citing and analyzing legal and other developments affecting the construction industry

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ILLINOIS MECHANICS' LIEN ACT AND CONSTRUCTION LAW UPDATE

The construction industry continues to present the courts with new dilemmas to resolve, and keeping up to date on all of the new legal developments in the industry can be a significant task. This update provides a summary of recent important opinions regarding the Illinois Mechanics' Lien Act and Government Contract issues.

I. The Illinois Mechanics' Lien Act

Over the last year, the Illinois Courts of Appeals and the Illinois Supreme Court have issued important opinions dealing with the Illinois Mechanics' Lien Act (the "Act"). The judicial trend indicated by these cases is that the Illinois courts strongly support the rights of subcontractors who are protected by the Act.

A. Failure to Give Notice to Lender Does Not Invalidate Lien

What happens when a subcontractor files notice against the owner but does not file notice against the lender? In *Petroline Co. v. Advanced Envtl. Contractors, Inc.*, 305 Ill. App. 3d 234, 238 Ill. Dec. 485, 711 N.E.2d 1146 (1st Dist. 1999), the Appellate Court held for the first time that failure to provide timely notice to a lender of a mechanics' lien does not render the lien invalid as to other parties.

In this case, the owners hired the defendant-contractor, Advanced Environmental Contractors, Inc. ("Advanced"), to install certain equipment on the property. The contractor bought the equipment from the plaintiff-subcontractor Petroline ("Petroline"). The subcontractor completed

delivery, but the bill was never paid in full. As required by Section 24 of the Act, within 90 days of completion of its work, Petroline served written notice on the owner that it intended to pursue its mechanics' lien. Thereafter, having failed to receive payment, Petroline recorded its lien within four months of delivery of the equipment and then filed suit to foreclose the lien within the required two years. Both Advanced and the lender were joined as defendants in the case. However, the trial court dismissed Petroline's lien claim because Petroline had failed to provide its Section 24 notice to the lender as well as to the owner.

Petroline appealed to the Appellate Court, which reversed, in part, the trial court's ruling. The Court of Appeals rejected the defendant-owner's argument that failure to provide notice to the lender completely invalidated the lien. The Court held that if an owner receives actual notice that in all other respects complies with Section 24, lack of notice to the lender will not invalidate the lien as to the owner. However, the Court affirmed that the failure to provide notice to the lender still rendered the lien unenforceable as to the lender. Accordingly, while notice should always be provided to all necessary parties, this case indicates the willingness of the Court to extend the protection of subcontractors' lien rights where a minor formal deficiency would otherwise void the same.

B. Automatic Stay of Bankruptcy Extends Mechanics' Lien Time Periods

Under normal circumstances, if an owner files a demand to enforce suit within 30 days, pursuant to Section 34 of the Act, the subcontractor must file a complaint to foreclose its mechanics' lien. The general contractor is a necessary party to such a suit. When this necessary party is in bankruptcy, thus staying and prohibiting any actions against it from proceeding, what must a subcontractor who receives such notice do? The Appellate Court answered this question and, in the case of *Chicago Whirly, Inc. v. Amp Rite Elec. Co., Inc.,* 237 Ill. Dec. 622, 710 N.E.2d 45, 304 Ill. App. 3d 641 (1st Dist. 1999), held that a bankruptcy filing by the general contractor, a necessary party to an action to enforce a mechanics' lien, extends the 30-day time period in which to file suit after receipt of a Section 34 demand.

In this case, the defendant-subcontractor, Amp Rite ("Amp

Rite") entered into a contract with the general contractor, Cinaco ("Cinaco"), to provide electrical labor and materials for the property of the plaintiff-owner Chicago Whirly, Inc. ("Chicago Whirly"). The plaintiff filed a declaratory judgment action against Amp Rite alleging breach of contract and further sought to declare Amp Rite's mechanics' lien invalid. Chicago Whirly also served Amp Rite with a Section 34 demand that Amp Rite file suit within 30 days. At the same time, the contractor, Cinaco, had petitioned for bankruptcy and an automatic stay had been entered by the Bankruptcy Court. Amp Rite argued it could not file suit because Cinaco was a necessary party to the mechanics' lien action and that the Bankruptcy Court's automatic stay prevented the filing of the lawsuit.

The trial court disagreed and granted Chicago Whirly's motion to dismiss the mechanics' lien. The trial court reasoned that the defendant could have complied with the Act by: (a) suing Chicago Whirly but not Cinaco and alleging the bankruptcy; (b) stating in the complaint that although Cinaco was a necessary party, Amp Rite could not join it; (c) asking the Bankruptcy Court permission to name Cinaco as a nominal party; or (d) simply suing Chicago Whirly to foreclose the mechanics' lien.

On appeal, the Appellate Court reversed. The Court held that Amp Rite did not forfeit its mechanics' lien when it failed to file suit against Chicago Whirly within 30 days of demand. The court stated that the automatic stay prevented Amp Rite from naming Cinaco as a party to the mechanics' lien action and that the time in which Amp Rite was required to bring suit to enforce a mechanics' lien was extended by the Bankruptcy Act. The Court relied on *Garbe Iron Works, Inc. v. Priester*, 99 Ill. 2d 84, 457 N.E.2d 422 (1983), which held that the Bankruptcy Act extended the two-year statute of limitations under the Act and applied the reasoning of that case to the Section 34 30-day demand requirement.

C. Can a Non-Owner Obtain an Attorneys' Fees Award Under the Mechanics' Lien Act?

In *Thomas Hake Enter., Inc. v. Betke*, 301 Ill. App. 3d 176, 703 N.E.2d 114, 234 Ill. Dec. 502 (2nd Dist. 1998), the Appellate Court answered that only the actual property owner can obtain such an award under Section 17(c) of the Act.

In this case, defendant Allen Betke purchased an undeveloped piece of property. Although Betke and a partner began to construct a residence thereon, they ultimately ran out of funds and could not complete the construction. A Ms. Charlotte Birck and her son, Jason, provided funds to purchase the lot and Betke's interest in the home. Although Ms. Birck paid the purchase price, she requested that the title to the lot be transferred to Jason's name rather than hers. Under the arrangement, Betke continued the construction through subcontractors that it retained, and Ms. Birck paid for the work. After the home was completed, Ms. Birck sold the property to yet other owners, Jack Bruns and Patsy Coffman.

Thereafter, a subcontractor, Thomas Hake Enterprises, Inc., brought an action against Betke, Charlotte and Jason Birck, Bruns and Coffman for breach of contract and to enforce its alleged mechanics' lien. The trial court dismissed the claims against all parties except for Betke, finding the mechanics' lien to be void. The judge then found that under the Act sanctions against the plaintiff were appropriate because the complaint was not well grounded. Ms. Birck was, therefore, awarded her attorneys' fees and costs under Section 17(c) of the Act.

On appeal, the Court of Appeals addressed a question of first impression: whether or not sanction awards under Section 17(c) of the Act are reserved solely for the actual property owners. Even though Ms. Birck participated in the negotiation of the purchase and sale of the property and financed the construction on the property, she was not the legal title holder. The Appellate Court, therefore, reversed the trial judge's ruling and held that Section 17(c) allows only owners to be awarded sanctions. The Court did state that a nonowner may still seek sanctions pursuant to Supreme Court Rule 137, which allows for the recovery of attorneys' fees in the defense of "frivolous" suits but in this instance, held that Hake's claim was not frivolous and that Ms. Birck was not entitled to any award.

D. Court Holds That Owners Jumped the Gun

Pursuant to Section 34 of the Act, can an owner demand a suit to enforce a lien before the claimant even files its lien? In *Krzyminski v. Dziadkowiec*, 296 Ill. App. 3d 710, 695 N.E.2d 1275, 231 Ill. Dec. 156 (1st Dist. 1998), the Appellate Court said no.

In this case, the plaintiffs, Leszek and Marie Krzyminski, contracted with defendant, Joe Dziadkowiec, to complete construction work on their property. By December 1995, more than six months had passed since Dziadkowiec had performed any work on the property. The Krzyminskis sought to resolve any potential future disputes with Dziadkowiec and, pursuant to Section 34 of the Act, issued a demand to file a lawsuit to enforce any lien he might claim, within 30 days. Dziadkowiec failed to respond to the demand. Pursuant to Section 35 of the Act, the Krzyminskis then issued a demand on Dziadkowiec to issue a release of any claim for lien, within 10 days. Dziadkowiec refused to issue a release, and the Krzyminskis filed this lawsuit to obtain a court order declaring Dziadkowiec's lien rights void and clearing the cloud of title to their property. Dziadkowiec responded by then filing his lien claim and asserting in defense that the Krzyminskis could not force him to file a lien complaint prior to having served his lien notice. The Court, reading Sections 34 and 35 of the Act together, agreed.

E. New Section 1.1 of the Act Held Constitutional

In *R.W. Dunteman Co. v. C/G Enter., Inc*., 181 Ill. 2d 153, 692 N.E.2d 306, 229 Ill. Dec. 533 (1998), the plaintiff, R.W. Dunteman Company ("Dunteman"), entered into a contract with the City of Des Plaines ("City") to perform road work on a street reconstruction project. The contract mandated that, among other things, all subcontractors were required to waive and release any and all liens and claims that might arise under the agreement. Dunteman subsequently subcontracted with C/G Enterprises ("C/G") to perform certain underground sewer and water construction. C/G then sub-subcontracted out portions of its work. During the project, the City became dissatisfied with the work of C/G and directed Dunteman to remove C/G from the project. Pursuant to Section 23, the lien on public funds section of the Act, C/G and its sub-subcontractors filed a lien against the monies due Dunteman. The City advised Dunteman that Dunteman's funds would not be released until the lien claims were resolved.

In response, Dunteman filed an action for declaratory judgment, requesting that the court find the lien claims void and unenforceable under the waiver provision in the contract. C/G counterclaimed that the waiver provision was void as against public policy based on Section 1.1 of

the Act, which prohibits "no-lien" clauses entered into prior to construction of the work on a project. The trial court upheld the waiver provision and further ruled that the new Section 1.1 was unconstitutionally vague and unenforceable. C/G appealed directly to the Illinois Supreme Court.

In reinstating C/G's lien rights, and striking the waiver clause in the contract, the Illinois Supreme Court supported the constitutionality of Section 1.1. The Court stated that the public policy behind the Act is to protect subcontractors who have expended labor and materials to improve real property at the direction of a contractor or owner. The Court reasoned that the legislature thus prohibited no-lien clauses because such waivers contravene the protective purpose of the Act. While Section 21 of the Act allows waiver of liens once work is completed, where the subcontractors are in a position to better determine whether they will receive payment, the Court argued that Section 21 does not contradict the Section 1.1 prohibition on lien waivers mandated in *anticipation* of contracts. The Illinois Supreme Court also ruled that the statute did not violate due process because the statute rationally related to the state's interest in protecting the rights of those who provide labor and materials.

II. Government Contracts and Delay Damages Claims

Two recent Federal Circuit cases provide support of the increasingly popular use of the "Eichleay" Damages Formula in the context of government contracts. These opinions strongly support the use of this damages formula, which seeks to allocate home office overhead and administrative costs to the delay period and to calculate the amount of recoverable damages based on this allocation, and clarify the standard of proof in cases of claims for delay attributable to the fault of the government.

A. West v. All State Boiler, Inc., 146 F.3d 1368 (Fed. Cir. 1998)

In this decision, All State Boiler, Inc. ("All State Boiler") contracted with the Department of Veterans Affairs ("VA") to upgrade the boiler system at a VA medical center. The contract contained a standard Suspension of Work clause, which provided that, if suspension or delay

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of the project occurred through an act of the VA, an adjustment would be made in any increase in the cost of performance caused by that delay. During the project, asbestos was discovered in the building and the project was suspended for 58 days until asbestos abatement work could be completed.

All State Boiler filed a claim for costs associated with this suspension. The VA's contracting officer denied part of the claim for unabsorbed overhead expenses, and All State Boiler appealed to the VA Board of Contract Appeals. The Board concluded that All State Boiler had successfully demonstrated that they were required to "stand by" during the government-caused suspension and that it was "impractical" for All State Boiler to take on additional work during that time. The VA argued that All State Boiler should be required to prove that it was impossible rather than impractical to take on other work. The Board rejected this argument and the VA appealed.

The Federal Circuit Court of Appeals affirmed the decision of the Board and ruled that under the Eichleay delay Damages Formula, All State Boiler was required to prove only impracticality rather than impossibility. Further, the Federal Circuit held that the *government* had the burden of establishing it was not impractical for the contractor to take on replacement work.

The Federal Circuit Court of Appeals also clarified the period of time for which delay damages are recoverable under the Eichleay Damages Formula. The Court held that a contractor can recover for that period in which its work or overall performance is extended rather than the number of days of the suspension. The Court reasoned that when a delay does not extend the contract completion time, the contractor suffers no injury. The contractor can, however, attempt to show that it could have completed the project earlier than the scheduled deadline and calculate damages from the early completion date to actual completion.

***B. Wickham Contracting Co., Inc. v. Fischer,* 12 F.3d 1574 (Fed. Cir. 1994)**

In *Wickham*, the Federal Circuit Court of Appeals held that: (1) the Eichleay Damages Formula is the *only* proper method of calculating unabsorbed home office overhead; and (2) costs directly attributable to specific projects cannot be included in the overhead pool.

In this case, Wickham Contracting ("Wickham") entered into a contract with the General Services Administration ("GSA") to renovate a post office. The GSA ordered a number of work stoppages on the project to allow time to resolve concerns about structural problems in the building. Due to these stoppages, the project was delayed by 969 days. Wickham disputed the amount the GSA granted it for unabsorbed home office expenses incurred during this delay period. Wickham argued that the percentage of home office overhead pool allocated to the contract based on the Eichleay Damages Formula was too low and did not fairly compensate Wickham for its overhead expenses. Further, Wickham contended that in denying Wickham's claim, the GSA's contracting officer wrongly excluded several specific field costs from the overhead "pool" to which it was entitled under Eichleay. The GSA Board of Contract Appeals rejected these arguments and Wickham appealed.

The Federal Circuit Court of Appeals held that the Eichleay Damages Formula is the "exclusive means for compensating a contractor for unabsorbed overhead when it otherwise meets the Eichleay prerequisites." The Court further stated that, "the Eichleay formula provides a feasible, equitable and predictable method of compensating a contractor for unabsorbed overhead." However, as to Wickham's specific claims, the Court held that direct field costs such as travel and meeting expenses are *not* overhead and cannot be included in the overhead pool of the Eichleay Damages Formula calculation.

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