



One Minute Memo®

Illinois Supreme Court Puts Owners and Developers on Notice of Payment Obligations For Construction Projects

The Illinois Supreme Court recently issued an opinion that may change the way payments are made on many construction projects in Illinois. Typically, in addition to lien waivers, owners insist on receiving a sworn statement from the general contractor that lists all subcontractors for the project, including material suppliers, as well as the amounts due and to become due to each for the balance of the project. This statement, commonly referred to as a Section 5 Statement, derives from section 5 of the Mechanics Lien Act (the "Act"), which requires owners to request and general contractors to provide the statement prior to any payments being made on the project. With the Section 5 Statement in hand, owners may make payments and are protected from subsequent claims raised by previously undisclosed subcontractors or for amounts that are in excess of those set forth on the Section 5 Statement (unless the owner had actual knowledge of such). Reliance on the Section 5 Statement in custom and practice has led many owners to believe that so long as they receive the statement, they may pay the general contractor all funds due subcontractors without further peril. Not true, says the Illinois Supreme Court.

In *Weather-Tite, Inc. v. University of St. Francis*, 2009 WL 1416108 (May 21, 2009), the owner, a university, hired the general contractor to renovate a residence hall. During the course of the project, the owner dutifully requested and collected Section 5 Statements from the general contractor prior to making payments to the general contractor for all sums due subcontractors. Four out of five times, the general contractor deposited the funds into its bank account and, in turn, issued checks to the subcontractors for their respective sums due. On the fifth time, however, the general contractor's bank exercised its right of set-off against the general contractor's account and applied the funds to an unrelated and outstanding debt of the general contractor. When the subcontractors were not paid, they liened the project.

Believing that it had done everything correct, the owner argued that the purpose of the Section 5 Statement was to provide an orderly method of making payments to subcontractors through the general contractor. Thus, because it had demanded and received such, the owner believed that it was free to make payments to the general contractor for funds due subcontractors without further liability.

The Illinois Supreme Court, however, rejected the owner's interpretation. It concluded that a Section 5 Statement is not merely intended to provide an orderly method of making payments to subcontractors. Rather, the purpose of a Section 5 Statement is to put the owner on notice of subcontractor claims and to create a duty upon the owner to protect those claims. Applying other sections of the Act, the *Weather-Tite* court concluded that the owner can fulfill that duty by retaining sufficient funds to pay the subcontractors (see Section 24 of the Act) and to make payments to subcontractors (see Section 27 of the Act).

The upshot of *Weather-Tite* is that owners are not immune from further liability unless subcontractors actually receive payment for the amounts listed in the Section 5 Statement. Thus, while owners, presumably for convenience sake, and consistent with custom and practice, have gotten into the habit of issuing payment solely to general contractors for all funds due subcontractors, they do so at their own risk. For, if the general contractor steals those funds or, as in *Weather-Tite*, if the funds are otherwise applied, then owners will find their projects properly liened. The answer may be that owners (and title companies) either begin to issue direct checks to subcontractors or joint checks to the general subcontractor and each subcontractor. Only then will the owner be able to rest comfortable that it has satisfied its obligations under the Act.

For more information, please contact the Seyfarth attorney with whom you work, or any other Construction attorney on our website (www.seyfarth.com/Construction).



Breadth. Depth. **Results.**

www.seyfarth.com