

Construx Redux

In a recent South Carolina federal court case, construction lawyers at Lathrop & Gage successfully represented a hotel owner against the general contractor, subcontractor, bonding company and window manufacturer because defective windows were installed in our client's multimillion-dollar hotel. The owner obtained 100 percent of the windows' replacement cost.

In this and other matters, construction clients – public and private owners, developers, architects, engineers, contractors, subcontractors and suppliers – rely on the experience of the Lathrop & Gage construction practice, which has grown to be among the largest in the Midwest with 18 attorneys. The practice serves the varied interests of public and private owners, developers, architects, engineers, contractors, subcontractors and suppliers.



Various members of Lathrop & Gage's Construction Law Practice from left to right: Dick Rhyne, Jeff Russell, Joe Fridkin, Mike Strong, Matt Hubbard, Ryan O'Dell, Jerry Bales, Sherm Botts, Justin Nichols, Kim King, Ken Snow, Jennifer Hannah, Pete Heaven, Scott Beeler, Steve Sutton and David Waters.

The group has expertise in every phase of construction projects, including bid protests and mistakes, unforeseen conditions, delay and extra work claims, warranty claims, defective design, mechanic's lien and bond claims, and liquidated damages. In addition, attorneys regularly advise clients at the initial stages of projects by facilitating development, negotiating contracts and structuring the project framework.

Lathrop & Gage construction attorneys litigate construction disputes in civil trial and appellate courts, and agency tribunals at the local, regional and national level. In addition, three members of the practice – Jerry Bales, Sherman Botts and Dick Rhyne – regularly serve as arbitrators and mediators in resolving complex construction matters through the American Arbitration Association and on a private basis.

For more information about the Lathrop & Gage construction practice, contact Sherman Botts at (816) 460-5523 or sbotts@lathropgage.com.

For more examples of the firm's construction cases, visit www.beentherewonthat.com.

“Pass-Through” Agreements Minimize Costs, But Are Not Without Potential Pitfalls

By Michael D. Strong, Member, Lathrop & Gage L.C.



Michael Strong

Liquidation or “pass-through” agreements are becoming an increasingly popular option in both public and private construction disputes. Although these types of agreements can be used in several different scenarios, the most common example involves situations in which a subcontractor and general contractor agree that the owner is responsible for the damages claimed by the subcontractor.

Without a liquidation agreement in place, the subcontractor would be obligated to bring its claims directly against the general contractor, who in turn would sue the owner. This arrangement requires the involvement of additional parties, and as a result is expensive and time-consuming.

In contrast, liquidation agreements allow the general contractor to “pass through” or sponsor the subcontractor's claim by bringing a claim directly against the responsible party and agreeing to turn over what recovery, if any, it ultimately obtains. By avoiding additional layers of litigation, costs are minimized.

However, a number of issues dictate when and if a liquidation agreement is appropriate. First, courts are split on whether the general contractor has to pay, confess or admit liability to the subcontractor to sponsor the claim, or whether it is sufficient that the general contractor merely be exposed to the subcontractor's claim.

Second, attempts to pass through claims may expose the general contractor to liability to the subcontractor in situations where the subcontractor does not agree that the owner is responsible for its claim, or the subcontractor does not agree to be bound to the result obtained by the general contractor.

When deciding whether the claim will be pursued directly by the general contractor, or by the subcontractor in the general contractor's name, several concerns must be addressed. Among them:

- If the general contractor pursues the claim directly, does it have a right to deduct its attorneys' fees and costs incurred from any recovery?
- Does the subcontractor have the right to participate, through its counsel or its expert, in the presentation of the claim?
- How should the recovery be apportioned between the parties in the event the general contractor is also pursuing an additional, independent claim?
- How would the recovery be divided between the general contractor and subcontractor in the event that a judgment or settlement fails to do so?
- How would the claim be resolved if the general contractor and subcontractor do not agree on what is a viable and fair settlement?

Many of these issues can and should be addressed as part of the initial contract drafting stage of the project to potentially avoid the necessity of negotiating a new, separate “pass-through” agreement when a dispute arises.

Michael Strong practices business litigation and commercial litigation. He can be reached at (816) 460-5539 or mstrong@lathropgage.com.

Midwest Construction Law Update

The Prompt Payment Act May Not Be So “Prompt” for Some

By Sherman Botts, Member, Lathrop & Gage L.C.



Sherman Botts

A recent decision from the Missouri Court of Appeals has limited the applicability of the Missouri Private Prompt Payment Act. For Missouri contractors, owners and subcontractors, this could require a change in the way payments are structured in construction contracts on private projects.

In the case of Vance Brothers, Inc. v. Obermiller Construction Services, Inc, the Court of Appeals reviewed a claim by a subcontractor against a general contractor for nonpayment. The subcontractor was applying microsurfacing to various Wal-Mart parking lots pursuant to a lump-sum contract, which paid the subcontractor only upon the completion of the work. A dispute arose concerning the quality of the work provided. The general contractor thought the work was substandard and withheld the payment from the subcontractor. In response, the subcontractor filed suit alleging various theories and causes of action, including a claim for attorney's fees and increased interest under the Missouri Private Prompt Payment Act.

The Court of Appeals rejected the Private Prompt Payment Act claim by noting that the act applies only to contracts for private design or construction work that involves “scheduled payments pursuant to the terms of the contract.” Because the contract at issue involved only one lump-sum payment rather than progressive or scheduled payments, the court concluded that the act was not applicable and accordingly, denied the claim for attorneys’ fees and increased interest.

Also, the court ruled that, if the Private Prompt Payment Act had been applicable, the general contractor was not entitled to withhold payment even under “good faith.” In a narrow ruling, the court distinguished the Missouri Public Prompt Payment Act with the Private Prompt Payment Act by recognizing that the Public Prompt Payment Act includes an express statutory provision entitling a contracting party to withhold payment in good faith. Because the Private Prompt Payment Act does not include such a provision, the court ruled that the good faith requirement cannot be “read into” the law. The decision is not clear as to whether the contract at issue involved an express provision entitling the other party to withhold payment for the good faith belief of improper or late work. As such, this decision -- which is the subject of an appeal to the Missouri Supreme Court -- casts doubt on the viability of a contract provision for withholding.

In light of this decision, if a party is interested in keeping the Private Prompt Payment Act applicable, the party should make sure that more than one payment is scheduled in the contract. This may be awkward on short-term contracts. However, by adding an initial or interim payment for a scheduled date, there is an increased likelihood that the Private Prompt Payment Act will apply.

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The Basics of Betterment

By Jerry Bales, Member, Lathrop & Gage L.C.



Jerry Bales

The issue of betterment, also called “added value” or “added first benefit,” is frequently raised in a variety of construction claims.

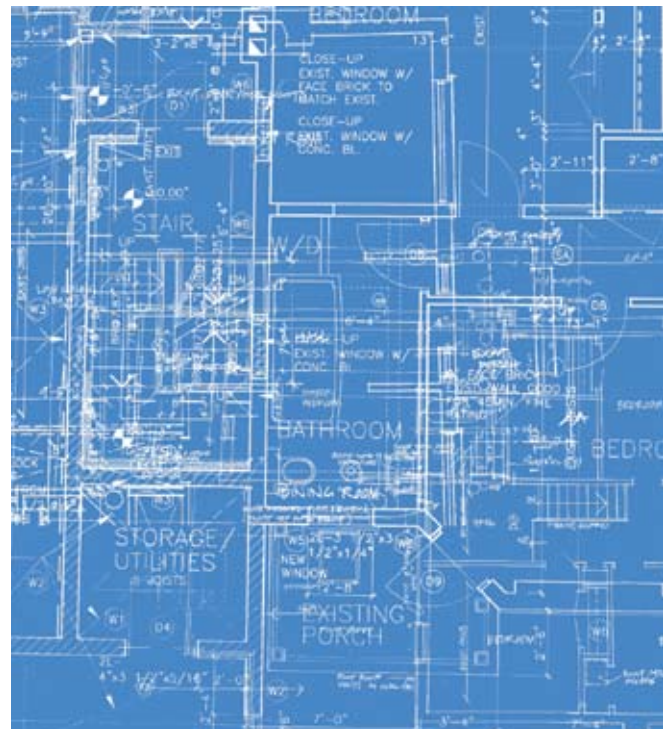
If a designer omits a critical item from the design, many courts have held that the owner should not be placed in a better position than if the contract had been fully or properly performed. That is, the owner should pay the cost of the item if it had been included in the original design documents. However, if the price of the item has increased since the date of the design, or if retrofitting is necessary because the error was discovered during or after construction, those expenses would generally not constitute betterment.

Similarly, if the omitted item is added by change order and the contractor includes a “premium” in its price -- a markup that would not have been charged if the item had been a part of the original bid by the contractor -- the premium would not constitute betterment to the owner.

Betterment is often applied when a building component with a clear useful life is replaced. For example, if an owner buys a 20-year roof and has to replace it after five years, the contractor/supplier may be able to reduce the owner's damages by 25 percent based upon the five years of use.

For more information on betterment -- nuances of the defense, which party bears the burden of proof and the many possible exceptions -- visit the Press Room at www.lathropgage.com, which features a paper on this topic that was presented to the American Bar Association's Construction Forum this spring.

Jerry Bales concentrates his practice on business litigation and professional liability. He may be contacted at (816) 460-5747 or jbales@lathropgage.com.



Missouri Suppliers Can Be Entitled to Mechanic's Liens Even if Material Is Not Installed

By Richard Rhyne, Member, Lathrop & Gage L.C.



Richard Rhyne

In a recent case of first impression, the Missouri Court of Appeals, Western District held that "the innocent materialman" should be entitled to a mechanic's lien even if the material is ultimately removed from the property.

In the case of Bates County Redi-Mix, Inc. v. Windler, et al, the supplier delivered concrete to a property for the construction of a basement by the owner's contractor. The concrete was poured into forms constructed by a subcontractor. It later was discovered that the basement walls were out of plumb, bowed and contained voids. The owner had the foundation torn out and refused to pay the general contractor for either labor or materials that went into the defective basement.

The testimony at trial was that the subcontractor's errors in setting the forms and pouring the concrete were the sole causes of the defective basement. The owner argued that "the material supplied must be integrated into the final structure in order for the supplier to be entitled to a mechanic's lien." The owner further argued that if the material was not incorporated into the structure, it had not improved that land and therefore did not meet the requirements of the Missouri Mechanic's Lien Statute.

The supplier argued that once the material was incorporated into the structure, its right to a mechanic's lien attached, and a removal of the material due to unrelated defects did not extinguish the lien.

The Court of Appeals agreed with the material supplier. The court reasoned that "the materialman stands in a far different position than a contractor." In this case, the court said the supplier "is totally innocent and removed from the malfeasance of the contractor . . ." and the owner is in a better position to ensure a contractor performs the work properly.

The court noted that while the owner in this case was also innocent, "given the purpose of the mechanic's lien law to encourage suppliers to extend credit to the land for improvements to be made," the proper result is to allow the mechanic's lien. The court concluded this result was consistent with the statutory intent to protect laborers and materialmen.

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Amendment to Kansas Statute Changes Mechanic's Lien Rules

By Don Dagenais, Member, Lathrop & Gage L.C.



Don Dagenais

As everyone in the construction business knows, an unpaid contractor or subcontractor on a construction or renovation project has the right to file a mechanic's lien against the property where the job was performed, as a means of securing its right to payment.

A mechanic's lien, if properly drafted, timely filed, and pursued by filing a lawsuit within the statutory time period, can offer an excellent way for a contractor or subcontractor to get paid for work performed. From the owner's standpoint, it represents a real threat to title to the property, which the owner certainly hopes to avoid.

In Kansas, a law that takes effect on July 1 has changed some of the major rules of the game in the realm of mechanic's liens, and makes it tougher for contractors and subcontractors to realize the benefits of these liens.

For many years Kansas, along with most other jurisdictions including Missouri, has recognized the "first spade rule" of lien priority. This rule holds that every mechanic's lien relating to a construction project "attaches" to the property and has priority as a lien from the date the "first spade of dirt" is thrown on the project. In other words, the very first day when construction commences is the day that governs, for purposes of the priority of every mechanic's lien that may later get filed.

This applies even to a subcontractor who wasn't even hired, or may not even have known about the project when the project commenced. The landscaping subcontractor who may have come in at the tail end of the project to lay the sod and plant the bushes and trees had a right, if unpaid, to file a mechanic's lien which would have priority dating all the way back to that fateful day when the "first spade of dirt" was thrown.

This rule gives mechanic's lien claimants a great advantage, particularly over other lien holders, like lenders, who might have liens (such as mortgages) that might be filed a few days or months after the first day the work was commenced. The new Kansas statute changes that. Now a claimant's mechanic's lien dates back only to the date upon which the earliest unpaid contractor or subcontractor began work. In other words, if the earliest subcontractors (such as the excavating subcontractor and the foundation subcontractor) are paid, but later subcontractors (such as the electrical or plumbing subcontractors) are not, the liens filed by the unpaid subcontractors date only from the date when the earliest unpaid subcontractor began work. This may be a year or two later than the date which would have governed before the new law was passed.

Moreover, the new law specifically says that if the earliest unpaid subcontractor is paid, the priority of other liens shifts up to the day the next earliest unpaid subcontractor started work. This allows

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an owner to pay off the earlier subcontractors, shifting the priority of the lien claimants to more and more recent dates, until the priority date reaches the point where it is recent enough that the liens become junior to other liens (for example, mortgages). So the priority date of a later subcontractor's mechanic's lien is now partially within the control of the owner. This is a concept completely new to Kansas mechanic's liens.

The new law also states that a contractor or subcontractor can only get a lien for labor, equipment, materials or supplies furnished "at the site of the property." This language will probably require some court interpretation, but on its face it seems to void any liens filed by subcontractors or suppliers who don't deliver their work or materials at the very site of the construction.

For example, what about a supplier who furnishes drywall, or paint, or lumber or steel, at an offsite location, which is then trucked to the site? What about the equipment company which rents construction equipment at its own location, which the contractor then transports to the job site? What about the gardening company which sells trees or bushes at its own place of business, which the landscaping subcontractor then transports to the building site for planting? Under a literal reading of the new wording, none of these suppliers could get liens on the property if they are unpaid.

This new law may substantially change the way construction materials and equipment are transported, as each supplier will now be advised to deliver its materials or equipment directly to the construction site itself.

Don Dagenais concentrates his practice on real estate and financial institutions law. He may be reached at (816) 460-5715 or ddagenais@lathropgage.com.

**Upcoming Construction
Seminar**

TOPICS INCLUDE:

- Recent developments in Missouri and Kansas Prompt Payment Acts
- Key contract provisions for the owner, contractor, architect and subcontractor
- Claims for extra work/preserving claims and defenses

Date: Thursday, July 14, 2005

Time: Noon to 3:00 p.m. (lunch will be provided)

Location: Crown Center office, 2345 Grand Blvd., 24th Floor

Registration: rsvp@lathropgage.com

Speakers Bureau Available

Attorneys in the construction group at Lathrop & Gage L.C. frequently speak at local and national seminars on topics affecting owners, contractors and design professionals. Lathrop & Gage construction lawyers also partner with clients to provide instruction on training on issues that affect their particular business. Recently, our attorneys have spoken on the following subjects:

- The Betterment or Added First Benefit Defense;
- OSHA and Residential Construction;
- A Road Map to the Standard of Care;
- Construction Law – Can this Job be Saved?;
- Recent ADR Developments in Construction Law;
- Mold – What's the Big Deal?;
- Hot Topics in Construction Law for Real Estate Professionals;
- Changes in Contracts and Differing Site Claims;
- Project Documentation and Preserving Claims: Key Construction Contract Provisions;
- Bid Protests and Bid Mistakes.

In addition to speaking engagements, Lathrop & Gage L.C. attorneys regularly author articles on topics of interest to the construction profession, on such subjects as:

- Prompt Payment Acts: Federal and Missouri;
- Missouri Mechanic's Liens;
- Kansas Notice of Defect / Right to Cure Act;
- Resolving Public Sector Disputes: A Road of Politics and Potholes;
- Construction Law Arbitration;
- Construction Law: From Getting the Contract to Chain of Liability;
- Construction Law Mediation.

**If you are interested in having a
Lathrop & Gage construction attorney
address your office or organization,
contact Sherman Botts at
(816) 460-5523.**