

**YOUR LEGAL TOOLBOX: TIPS FOR MICHIGAN
CONTRACTORS, SUBCONTRACTORS AND OWNERS
TO GET PAID AND PROTECT YOURSELF IN A TOUGH ECONOMY**

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Although the news and political pundits disagree about whether the United States is in a recession or a depression, the reality is, if it's a matter that's up for debate, things aren't good. But just because things are bad out there doesn't mean that there aren't ways you can protect your business, your property, or your construction project while the economy persists in a downward slide. In fact, there are things you can do to ensure that while other businesses make critical errors and get swept from existence, yours will weather the storm and ultimately come out ahead.

Thus, while certainly not exhaustive, following are some tools under Michigan law that might prove helpful in getting paid for your work, or protecting your construction project.

I. For Contractors and Subs, Collecting What You're Owed

In times of economic hardship, owners take longer and longer to pay and general contractors take longer to transmit these payments to subs, which might put you (wherever you fall on the totem pole) in a difficult position when it comes to collecting what you're owed. One of the most important things to understand under those difficult circumstances is how to go about collecting what you're owed, so here's a refresher course on two of the most important tools in your toolbox for getting paid: filing construction liens and making claims on payment bonds.

Construction Liens

The power of the construction lien cannot be understated, and it is critical that if the project you are working on is lienable (that is, it is not a municipal project or otherwise publicly funded), you must protect your lien from the outset and follow through up to foreclosure and legal action if necessary.

- *Who has lien rights?* Under the Michigan Construction Lien Act, contractors, subcontractors, suppliers or laborers who provide improvements to real property have a construction lien under appropriate circumstances.
- *Do I need to have a contract in place in order to file a claim of lien?* Yes. A contractual entitlement must exist for a valid lien to exist. However, if you don't have a contract that's in writing, that doesn't necessarily mean that you don't have lien rights. Contracts can be oral *and* entitle you to a lien, so long as they satisfy some certain basic requirements – check with your attorney.
- *What needs to be in place before I file a lien?* Before you have a right to your lien, certain documents must be in place:

Notice of Commencement: Before work begins on a project, the owner must file a Notice of Commencement, and this notice must be posted on the project site. The notice will contain a description of the property, information about the owner and the general contractor. If you don't see

the Notice of Commencement posted at the project site, ask the general contractor or the owner.

Notice of Furnishing: This document must be given to the owner and the general contractor by all subcontractors or suppliers within 20 days after furnishing the first labor or material (laborers have 30 days). If you fail to provide a notice of furnishing or file a late notice of furnishing, you may waive some or all of your lien rights – check with your attorney.

Sworn Statement: When requesting payment, this document must be given by the general contractor to the owner, and from subcontractor to the general contractor. The statement must contain specific information including the names of all subcontractors, suppliers and laborers who are owed monies but have not been paid, type of improvement provided, total contract price for each, amount paid and owed, and the balance to complete the work, among other things.

Lien Waivers: Although you may sign partial lien waivers as you receive partial payments, do not sign a full unconditional lien waiver unless you've been paid in full! Waivers waive lien and payment rights and must be examine carefully prior to signing to ensure that you're not signing away your rights to a lien or future payments. If you have any questions about what you're signing, consult a lawyer.

- Perfecting Your Lien: To perfect your lien, you must record your claim of lien with the registrar of deeds located in the county in which your project is situated within 90 days of providing last labor or materials. Fifteen days

after the lien has been recorded, you must serve your claim on the owner. The claim of lien must include some very specific information about your job, including a legal description of the property improved, the dates when you first and last provided labor or materials, the name of the owner, the total amount of your contract, including extras, the amount received to date and the amount you are owed, among other things.

- *Enforcing Your Lien:* If you still haven't been paid in full after you have filed your claim of lien on the property, you must enforce your lien through a foreclosure action within one year of the date the lien is recorded or risk losing your lien rights entirely. If you decide to commence a foreclosure action, you will need to employ an attorney unless you are representing yourself and not an incorporated entity. And even if you are able to represent yourself, strongly consider engaging an attorney anyway. Establishing your right to a lien requires careful and accurate work, so why risk losing the fruits of that work by failing to properly navigate legal waters? Better yet, the Michigan Construction Lien Act allows for the recovery of attorney fees if you emerge victorious in your foreclosure action.

Payment Bonds

If you're working on a publicly-funded project, you won't have the right to a lien in the event of non-payment, but you will be able to make a claim on the payment bond, which must be in place for such a project under Michigan law. A payment bond is a promise by a surety (usually an insurance company) to pay subcontractors or suppliers if

the general contractor does not pay. If you have a contract directly with the general contractor, you can file a claim on the bond if you are not paid within 90 days from last day labor or materials provided, and if necessary, you must file a lawsuit on the bond within one year from the date that final payment is made to the general contractor. If you do not have a contract directly with the principal contractor, you must jump through a few more hoops, such as:

- Provide notice to principal contractor within 30 days of first providing labor or materials to the project (send notice via certified mail)
- Provide notice to general contractor and owner within 90 days from last day labor or materials provided (60 days for highway projects)
- File your lawsuit within one year from the date that final payment is made to the general contractor.

If you happen to be working on a federally-funded project that is bonded (usually for projects worth \$25,000 or more), no notice is required when commencing work, but notice is required within 90 days of last providing labor or materials and your lawsuit must be filed within one year from your last providing labor or materials.

Additional Considerations

Some additional ideas for protecting your rights to payment for your work include:

- Don't wait for the project to be completed to assert your lien or bond rights.

Waiting could mean waiver of those rights.

- If you're not getting paid, contact the owner. Chances are, if the owner is faced with a potential lien, the owner will choose to pay you before the general contractor.
- Suggest to the owner that joint checks be issued for your work in both your name and the general contractor's name. This avoids the surreptitious use of funds intended to pay for your work for the general contractor's other bills.
- As soon as you aren't being paid on time, identify the surety (if there's a bond) and pursue the surety for what you're owed.
- If the prime contract or your contract is based on a standard AIA form, check to see if it provides for you to demand and receive assurances from the owner that the owner is able to pay before you continue with your work – if the contract is unaltered, it should allow for you to do so (in fact, the '97 version of the AIA standard contract even allows you to demand assurances at any time).
- Check the payment history of the owner and/or the general contractor. Getting a simple Dunn & Bradstreet report could inform your decision about whether or not you want to work on the project at all. As hard as it is to turn down work in stressful economic times, it's better to turn down work from an unstable source than to commit precious resources to a project and not get paid.

II. For Owners, Avoid Liens And Get Your Project Completed

Michigan's Construction Lien Act protects owners as well as contractors and subcontractors. To protect themselves from liens, owners should always demand lien waivers for each progress payment made. If you receive notice from subcontractors, laborers or suppliers that they aren't being paid by the general contractor, you should

make payments directly to those people to avoid any liens that they might assert as well as making double (or triple, or worse) payments for the work done on your project.

III. Dealing With Increased Costs Of Materials

Every fixed-price contractor has felt the pinch of increased materials costs arising in the course of work on a project. Typically, fixed-price contracts require the contractor to assume the risks of materials costs fluctuations, and contractors take such potential fluctuations into account in preparing bids and negotiating prices. To guard against an unanticipated rise in materials costs, fixed-price contractors should attempt to include price-adjustment or escalation provisions to shift some of the burden of increased costs upstream. If the owner of the project is unwilling to agree to such a provision, a contractor might be more successful including a clause whereby the contractor assumes the risk of reasonably foreseeable increased costs, but the owner assumes the risk of increases that *could not have been* anticipated. For instance, the contractor may prepare an escalation clause which provides relief where key material costs increase beyond a specified range. Like differing site condition clauses, the contractor's justification for such a clause is that an escalation clause avoids the necessity of contingency pricing which may prove more expensive to the owner than its acceptance of the risk of excessive price increases. Of course, cost-plus contracts are another excellent means of sharing costs increases, assuming the owner (or upstream contractor) is amenable.

IV. Bankruptcies

Once an owner or contractor files for bankruptcy – to quote a famous movie line – you're not in Kansas anymore. The bankrupt entity converts to an estate for the benefit of the creditors and a whole host of detailed procedures apply that cannot be discussed at

any length in this article. However, it might be helpful for you to be aware that in the event of a bankruptcy, you may still be entitled to the progress payments you've earned thus far on the project notwithstanding the Bankruptcy Code's ordinary preferential payment doctrine (which voids payments made within 90 days of the bankrupt entity being declared insolvent). Under most circumstances, those progress payments are held separately from the bankrupt estate and secured in a special builder's trust fund.

Also helpful in uncertain economic times is to make sure that your contract protects you in the event that the general contractor or owner becomes bankrupt. For example, you should make sure that your contract allows for the contract to be terminated in the event of the upstream party's bankruptcy, and that the contract allows for it to be assigned to another party under those circumstances.

V. Parting Thoughts

Although you ultimately cannot protect yourself, your business or your construction project from all financial perils, there are certainly some things that you can do at the outset to make sure that you are in a better position in the event of a non-paying general contractor or owner. If you have questions, or you think you may need legal assistance, please feel free to call the Wisley Law Firm, PLLC at (248) 339-9819 or e-mail us at info@wisleylawfirm.com.