SANDBERG PHOENIX

CONSTRUCTION BLOG

Liens and Bonds: Bad Things Happened,

Then Good Things Happened

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"I like things to happen and if they don't happen I like to make them happen." - Winston Churchill to Arthur Ponsonby MP, 1929

Bad Things Happened

In 2016, bad things happened to the lien rights of subcontractors and suppliers in Missouri because of a bad court decision. Then in 2019, American Subcontractors Association (ASA) and its industry partners made good things happen in the legislature with the passage of a favorable law to overcome the bad court decision. The problem started when the Supreme Court of Missouri unexpectedly ruled that a subcontractor had neither a bond claim nor a mechanic's lien claim against the real estate owned by a county but leased by it to a private entity to be used by that entity as its corporate headquarters.

In this case, the property was owned by St. Louis County. It adopted a resolution authorizing the issuance of Industrial Revenue Bonds (IRBs) to finance the development and construction of Six City Place to be leased to Smurfit-Stone Container Enterprises, Inc. as its corporate headquarters. No part of the project was to serve a governmental purpose. Clayco, Inc. was hired to serve as the project's general contractor. Subcontractors were hired, but not fully paid. Liens followed.

For decades, governmental bodies have issued IRBs as a means of financing private construction projects in order to spur economic growth in their jurisdictions. Also, for decades, subcontractors have successfully filed mechanic's liens against the government's fee simple interest in the real estate to secure payments due to them for improving the real estate, but in 2016, a bad thing happened.

The Supreme Court of Missouri ruled that a subcontractor had no right to file a mechanic's lien against St. Louis County's interest in the real estate. The court did, however, recognize the subcontractor's right to file a lien against the tenant's leasehold interest, a right of dubious value. The court's reasoning for denying the lien against the owner's interest was based on the theory of sovereign immunity. While it is the unquestioned law in Missouri and elsewhere that there can be no mechanics' liens against government-owned property *used for governmental purposes* such as jails, courthouses, schools, fire houses, etc., the Supreme Court did not examine precedent recognizing the right to file liens against government-owned property *that was not used for a governmental purpose*.

Having lost its lien claim, the subcontractor advanced an alternative theory arguing that where there is no lien right there should be a payment bond in place to serve as security for the amount due the subcontractor. The Supreme Court said "no" to that argument as well, ignoring a long line of Missouri cases consistently recognizing a seamless continuum of payment protection where courts have held subcontractors are entitled to either bond rights or lien rights.

What makes this ruling so remarkable is that none of the parties – St. Louis County, developer, or lessee – challenged the subcontractor's right to have a lien against the County's interest in the real estate. The court's ruling was purely gratuitous.

Then Good Things Happened

Legislative Cure

The American Subcontractors Association Midwest Council and other industry associations – SITE, PDF, NECA, Associated General Contractors (AGC), the Surety Association, and their respective lobbyists – championed the cause for a legislative cure to the court's adverse ruling.

As a result of legislation introduced by Senator Sandy Crawford and Representative Aaron Griesheimer, subcontractors, suppliers and even general contractors, will have their payment rights protected by a payment bond posted by the party who contracts with the governmental body for development/construction. For projects financed through IRBs, this party is typically the developer.

Under prior law, a contractor who entered into a construction contract worth more than $50,000 was required to post a payment bond for the protection of its subcontractors, sub-subcontractors and suppliers. Usually, this was a general contractor. In doing so, the general contractor was thereby assuming potential liability (along with its surety) to unpaid subcontractors, sub-subcontractors and suppliers. The new law expands the definition of a "contractor" who must post a bond to also include anyone who "contracts, provides, or arranges for construction services on a public works project for a nongovernmental purpose when acting as a lessee, agent, designee, or representative of a public entity." This is done in anticipation that it is the developer who will have a direct contract with the governmental body owning the real estate, not a general contractor. Accordingly, in such cases it becomes the developer's responsibility to post the payment bond. This is a benefit to general contractors who are accustomed to posting the bond as "principal" with resultant potential liability. Without being the principal on the bond, the general contractor will join subcontractors, sub-subcontractors, and suppliers as beneficiaries of the bond on government projects used for nongovernmental purposes without any corresponding diminution of rights or protection to subcontractors, sub-subcontractors, and suppliers. However, on traditional types of governmental projects used for governmental purposes, the general contractor will still have to post a payment bond for the protection of subcontractors and suppliers.

If this is not the first statute in the country offering a general contractor payment bond protection, it is a rarity. While the new statute makes clear lien rights do not exist on these types of projects, payment bond rights are secured, thus once again affirming the principle of a seamless continuum of protection for subcontractors and suppliers.

Suppliers' Rights Expanded

Under existing law (pre-August 28, 2019), Missouri courts only allowed bond rights to extend down as far as third-tier parties, that is to sub-subcontractors or to suppliers to a subcontractor; whereas, a supplier to a sub-subcontractor (fourth-tier) had no rights under the bond. This limitation was especially problematic with the increasingly frequent practice by contractors of inserting subsidiaries or related entities into the contract chain as additional parties. Also, with the inclusion of minorities as material suppliers, yet another layer is inserted into the food chain, resulting in the actual suppliers often finding themselves too far down the food chain to be fed through the use of a payment bond. This problem was successfully addressed and redressed in the same legislation addressing bond claims on government property used for a nongovernmental purpose. The roadblock preventing claims by suppliers below the third-tier has been removed thanks to this new legislation.

For post-August 28, 2019, projects, “remote” suppliers “at any tier” will be able to make claims under a payment bond. But to be entitled to this protection they will be required to give to the principal of the bond written notice within 90 days of the time they last supplied materials on the public works project that they have not been paid. The expansion of bond rights to remote suppliers is not limited to only projects owned by a governmental body used for a nongovernmental purpose, but also applies to remote suppliers on all government projects regardless of use.

Like Churchill, ASA and its partners teamed to “make things happen.” These changes happened because the industry coalition successfully lobbied – through their respective lobbyists – the Missouri legislature with the result of the passage of a law (1) materially expanding bond rights to more suppliers on all government projects and (2) effectively overruling an unfortunate Supreme Court decision. Without the help of the AGC, it would have been more difficult to secure passage of this legislation.