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Court Adopts New Rule for Construction Manager Liability

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The Illinois Appellate Court recently revisited the issue of whether a construction manager can be liable for injuries to a construction worker caused by a contractor who was hired by the owner. See Calloway v. Bovis Lend Lease, Inc., 2013 IL App (1st) 112746.

The liability of construction managers in such situations is governed by Section 414 of the Restatement (Second) of Torts. Section 414 states:

> One who entrusts work to an independent contractor, but who retains the control of any part of the work, is subject to liability for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care.

In Calloway, the complaint alleged that a construction manager was liable for an accident that grievously injured a construction worker and killed his father because the construction manager negligently failed to halt the hazardous practices of a subcontractor. The construction manager argued that it did not entrust work to the subcontractor because it did not hire the subcontractor. The jury entered a verdict in favor of the plaintiffs and against the construction manager.

The construction manager appealed the jury verdict, relying upon a similar case where the court held that the construction manager was not liable. O'Connell v. Turner Constr. Co., 409 Ill. App. 3d 819 (1st Dist., 2011).

In O'Connell, a school district hired a construction manager to build a new high school campus. Under that contract, the school district was responsible for hiring subcontractors directly. In O'Connell, an employee of one of the school district's subcontractors was injured while working at the construction site and brought a lawsuit against the construction manager claiming negligence under Section 414. The worker alleged that the construction manager was liable for his injuries because it exercised significant control over the trade contractors, particularly with regard to safety. The trial court granted summary judgment in favor of the construction manager and the worker appealed.

In O'Connell, the appellate court held that the prerequisite for applying Section 414 was entrustment of work to an independent contractor by the construction manager and that, absent such entrustment, Section 414 was inapplicable. The O'Connell court held that since the school district, rather than the construction manager, entered into the contract with plaintiff's employer, the construction manager did not entrust work to the plaintiff's employer and that plaintiff's Section 414 claim failed as a matter of law.

The court in Calloway, however, disagreed with the O'Connell court and elected to follow a line of subsequent federal cases that had analyzed the entrustment requirement. Those cases analogized the entrustment requirement in Section 414 cases to the control requirement in Section 414 cases. In Section 414 cases, the control requirement can be met with respect to a construction manager where evidence of the construction manager's actions

demonstrates that it retained a sufficient level of control, even where the contractual language formally assigns control to the independent contractor.

The Calloway court stated that the entrustment requirement should be evaluated in the same manner as the control requirement and upheld the finding against the construction manager. Consequently, under Calloway, the entrustment requirement should be decided based upon whether the circumstances of each case show that the construction manager actually entrusted work to a subcontractor and not based upon a bright-line test such as whether the construction manager actually signed the contract with the subcontractor.

Court Gives New Meaning to Certificate of Insurance

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In Mt. Hawley Insurance Co. v. Robinette Demolition, Inc., 2013 IL App (1st) 112847 , the Illinois Appellate Court looked at a certificate of insurance in order to find coverage for an additional insured. The court did so by finding that the certificate constituted part of an "ongoing transaction." This is a departure from prior law and brings back new relevance to certificates, which have long been viewed as not worth the paper they are printed on.

The case arose from a typical construction loss. A concrete cutting service entered into an "ongoing subcontract agreement" with a demolition company. That agreement included a requirement that the concrete cutter defend and indemnify the demolition company and "any and all other Additional Insureds specified in Schedule `B' hereof." Schedule B, in turn, listed the required policies and required the concrete cutter to add the demolition company and "any other parties as may be reasonably required by" it to the concrete cutter's policies as additional insureds.

The concrete cutter satisfied the requirements of insurance through a policy of insurance issued by Mt. Hawley. The policy provided coverage to the concrete cutter and all persons which the concrete cutter agreed in writing in a contract to add as additional insureds to its policy.

On February 10, 2009, the demolition company sent the concrete cutter a work order for a project. There was no mention of the general contractor in that work order. The demolition company received a certificate of insurance naming the demolition company and the general contractor as additional insureds.

Subsequently, an employee of the concrete cutter was injured while working on the project. He later sued the demolition company and the general contractor. The general contractor sought coverage under the Mt. Hawley policy. Among other reasons, the general contractor tender was denied on the basis that there was no written contract requiring that the general contractor be added to the concrete cutter's policy.

The trial court found that there was no requirement in the work order stating that the general contractor was to be named as an additional insured under the demolition company's insurance policy. Accordingly, the trial court had held that the general contractor was not an additional insured.

The appellate court looked at the extrinsic evidence and found that the normal course of procedures between the concrete cutter and the demolition company was that the demolition company would advise the concrete cutter as to the required additional insureds and the concrete cutter would provide a certificate adding those parties. As such, the appellate court reasoned that the certificate was one more part of the ongoing transaction and served to meet the requirement for a written contract. Even though the service agreement, the work order and the certificate were not executed at the same time, they were part of the same transaction. As such, the appellate court reversed the trial court and found that the general contractor was an additional insured.

LLC and a Member Are Not the Same Person

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In the recent case of Peabody-Waterside Development, LLC v. Islands of Waterside, LLC, 2013 Ill. App. (5th) 120490, the Illinois Appellate Court ruled that a member of a limited liability company can file a mechanics lien against property owned by the LLC. In Peabody-Waterside, the member had a 50% interest in an LLC that owned 900 acres of real property that was going to be developed using the funds provided by a bank. The LLC attempted to obtain bids for the intended work, but was unable to find any bids that did not far exceed the expected costs of the development. Needing to complete the work, the LLC hired the member to perform the work on a cost-plus basis. The member performed the work, but was not paid by the LLC.

Upon failure of payment, the member filed a notice of lien and then suit for breach of contract and foreclosure of the mechanics lien against the LLC and the other entities with interest in the property. The bank moved for the trial court to hold that the lien was invalid based on the fact that the member was a 50% owner of the LLC, and therefore, the member had a co-ownership interest in the real estate owned by the LLC and could not perfect its lien. Moreover, the bank argued that as a partial owner, the member was not the type of claimant that was entitled to a mechanics lien under Illinois law. The trial court accepted this argument and entered judgment on the mechanics lien issue in favor of the bank and against the member. The member appealed and the appellate court reversed.

The appellate court found that, under Illinois law, an LLC is an independent legal entity which has legal rights and obligations different from the rights and obligations of a joint venture. The appellate court determined that a membership interest in a limited liability company does not confer the ownership interest in the property owned by the LLC upon the member. Contrarily, in a joint venture, both members of the joint venture share ownership of the property of the joint venture. Therefore, the appellate court found that the members of the LLC could lien the property owned by the LLC.

Piercing the Limited Liability Company Veil

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Courts use the doctrine of "piercing the corporate veil" as an equitable remedy to impose liability on an individual or entity using a corporation merely as an instrument to conduct that individual's or entity's business. Although the Illinois Limited Liability Company Act specifically provides that members of an LLC will not be personally liable for failing to observe corporate formalities, the Illinois Appellate Court recently affirmed the application of the doctrine to an Illinois LLC in Seater Construction Co., Inc. v. Deka Investments, LLC, 2013 IL App (2d) 121140-U.*

There, the plaintiffs sought to pierce the veil of an investment company formed as a limited liability company by two individual members. The plaintiffs, two construction companies, entered into contractual agreements with the LLC to provide construction management and carpentry services for the development of a retail complex. The LLC withheld payment from the plaintiffs because the company members disputed whether the plaintiffs fulfilled all of their obligations under the terms of the contract.

With the exception of the plaintiffs, all other subcontractors associated with the construction project received payment from the LLC. The plaintiffs filed a claim for breach of contract against the LLC, and although the trial court held in favor of the plaintiffs, the LLC was dissolved during the pendency of litigation and the trial court refused to pierce the corporate veil of the LLC so the plaintiffs could recover damages against the individual members.

Prior to this case, no Illinois court had held that the doctrine of piercing the corporate veil applied to an Illinois limited liability company. Here, the court accepted the applicability of the doctrine to LLCs, but refused to pierce the veil.

To determine whether to pierce the corporate veil of the LLC, the court employed a two-prong test:

(1) whether there is such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist; and

(2) whether circumstances exist such that adherence to the fiction of a separate corporate existence would sanction a fraud, promote injustice, or promote inequitable consequences.

In discussing the first prong, the court considered various arguments raised by the plaintiffs. First, the plaintiffs argued that the LLC was inadequately capitalized. However, the court recognized that adequate capitalization depends upon the amount of capital compared to the amount of business to be conducted and obligations to be fulfilled. Because the LLC had substantial equity in the subject property and the LLC members had paid all of the subcontractors in full with the exception of the plaintiffs, the trial court's finding that the defendant was not undercapitalized was not against the manifest weight of the evidence.

Second, the plaintiffs argued that the LLC members commingled funds when one member directed title indemnity funds to herself, and disbursements from a construction escrow account to the members and her son's college. The court disagreed, holding that every payment was a legitimate business expense. A single payment of $500 to the son's college was insufficient to hold that the trial court's finding was against the manifest weight of the evidence.

Last, the plaintiffs argued that the LLC members diverted assets from the LLC once the plaintiffs filed a mechanics lien on the property and were not paid. However, the trial court found that payments made to the LLC members and other subcontractors were reasonable and proper.

The court's analysis of the factors argued by the plaintiffs dictated the court's holding under the second prong of the test to determine whether to pierce the corporate veil of the LLC. Nothing in the record suggested that the LLC member drained the company's funds to avoid paying the plaintiffs. The members paid all other subcontractors and attempted to operate the LLC as a viable business. Therefore, the court upheld the trial court's ruling that the defendant's corporate veil would not be pierced under the circumstances.

*The "U" at the end of the case citation means that the opinion may not be used as precedent for other cases.

Court Upholds Contractual Forum Selection Clause

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An Illinois Appellate Court recently held that a forum selection clause in a standard contract was valid and required the parties to litigate the contract in Colorado even though their headquarters were in Illinois. Brandt v. MillerCoors, 2013 IL App (1st) 120431. In Brandt, a company entered into a contract with a brewer to provide professional parts procurement and management services to breweries located in four states. It provided logistical support from its Illinois office. The brewer's performance of the contract occurred primarily in Colorado where its strategic sourcing and procurement operations were based.

Between July 2009 and early 2010, the parties met five times, mostly in Colorado, to negotiate the contract's terms. The executed contract contained a forum selection clause mandating that any disputes be litigated in Colorado. After the parties began performing under the contract, the brewer received complaints and notices of mechanics liens stemming from the consultant's failure to pay suppliers. As a result, the brewer cancelled the contract.

The successor to the consultant filed suit in Illinois. The brewer moved to dismiss the complaint on the ground that the forum selection clause precluded litigation in Illinois. The court granted it.

On appeal, the consultant raised three issues. First, the forum selection clause was invalid since it denied the consultant its day in court. Second, the consultant was unable to negotiate the clause, and, lastly, the brewer fraudulently induced it to sign the contract.

The appellate court held that contractual forum selection clauses are prima facie valid and affirmed

the trial court's ruling after considering the following factors:

1) the law governing the formation and construction of the contract;

2) residency of the parties;

3) location of execution/performance of the contract;

4) location of the parties and witnesses;

5) the inconvenience to the parties of any particular location; and

6) whether the parties bargained for the clause.

Here, no evidence proved that the forum selection clause "was so gravely difficult and inconvenient" that the consultant would be denied its day in court. In fact, the only factor favoring Illinois as the forum state was the location of the parties' headquarters.

Next, the consultant contended that it would face hardship and inconvenience if Colorado was the forum state since its witnesses and evidence were in Illinois. However, the court noted that "mere inconvenience is not a reasonable basis for voiding an express forum selection clause."

The consultant also claimed that the brewer was in a superior bargaining position and had engaged in a fraudulent scheme, involving the forum selection clause, to financially ruin the consultant so it could not afford to litigate in Colorado. This argument failed, however, because in order to invalidate a forum selection clause, the alleged fraud must be specific to the clause.

December 10, 2013
Construction Lien Seminar

On December 10, 2013, in Elk Grove Village, Illinois, Querrey & Harrow attorneys will present a one-day seminar entitled "Construction Lien Law in Illinois." This Lorman Education Services seminar is designed for contractors, owners, developers, subcontractors, suppliers, architects, engineers, lenders, accountants, and allied construction professionals. Construction Practice Co-Chair Bruce Schoumacher will serve as Moderator for the seminar. Other speakers include John Brom, Jason Callicoat, Douglas Giese, Nicholas Johnson, Thomas Kaufmann, Anthony Madormo, and Timothy Rabel of Querrey & Harrow, and Kimberly Reome of The Kenrich Group.

As a friend of Querrey & Harrow, you can receive 20% off the registration fee. Please contact Amy Kozy via akozy@querrey.com for more information on this special offer.

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