Corporate and Construction Newsletter

November 2012

INSIDE THIS ISSUE:

Please Join Us!

Willis Insurance and Bryce Downey & Lenkov will be co-hosting their annual Bankers Roundtable seminar on 11/7/12 from 7:45 am until noon. Topics include:

- Have Credit Conditions Eased?
- Construction Defects -The Roof Leaks! Who Pays?
- Pollution and Contamination – Does My CGL Policy Cover That?
- Pollution Liability Insurance & The Project Site
- Online Collaboration Platforms
- Green Buildings

There is no charge for this seminar. If you can't attend in person but would like to be included, the seminar will be available via live webinar. To RSVP for this event or for more information, please email dshelist@brycedowney or call 312-327-0029 by Nov. 2nd.

2012 was better than 2011! Will we see improvement after the elections?

By Geoffrey A. Bryce

In September, the Federal Reserve re-affirmed its commitment to keep short-term interest rates near zero through 2015.

In September, the Illinois Association of Realtors reported that August home sales for the 9 county Chicago area rose by 28.5% compared to August, 2011. The 9,240 homes sold was the best month since August, 2007 when 9,733 homes were sold. However, of the closed transactions, almost 38% were for foreclosures and short sales. Depending on the neighborhood, some prices are starting to increase; but current prices remain below 2007 levels. Even though new construction is picking up, experts estimate that there is a 3 year inventory of homes on the market. The inventory of homes is being reduced by investors and new home buyers. Construction of apartment buildings is a bright spot.

The US unemployment rate dropped to 7.8% in September, which was the first time since January, 2009 that the rate was under 8%. Although the unemployment rate for Illinois is about 8.8%, Chicago has been adding jobs throughout the past two years.

According to the Wall Street Journal (8/6/12), banks were easing their lending standards for medium size businesses. Our Chicago and Indiana banker friends are looking to make loans.

The Journal (10/4/12) also reported that vacancy rates for malls in the top 77 US markets dropped to 8.7% in the third quarter, which was an improvement over the 8.9% vacancy rate in the second quarter; however, rental rates continue to be depressed.

September auto sales jumped 12.8% from a year earlier. Almost 1.2 million vehicles were sold, which is the highest amount since March, 2008.

Although we have seen improvement throughout 2012, we are still faced with "Fiscal Cliff" issues in Washington, and Springfield needs to address pension and deficit issues. With elections only a few days away; hopefully, our new President and the federal and local legislators find common ground and pass legislation that will accelerate the economic recovery in a fiscally responsible manner.

By the end of October, we will be in our new Crown Point, Indiana office; and we now have 7 attorneys who are licensed in Indiana. By the end of the year, we will have increased the size of our Chicago office by 25%. We are very pleased that Ioana Salajanu and Jeff Kehl have joined our firm as partners. Ioana has a wealth of corporate litigation and transactional background, including experience in commercial foreclosure defense. Ioana joins our firm members who speak Spanish, and she also is fluent in Romanian, French, and Italian. Jeff is licensed in Illinois, Indiana, and Texas, and he has tried over 40 jury trials and argued many appellate cases. We are very excited about our firm's growth as we wrap up 2012 and look forward to 2013.

We believe that with continued low interest rates, a willingness of banks to be more creative in making loans, job creation, and improvement in the housing market; entrepreneurs will be willing to expand their businesses as we enter the New Year.

If you are downtown or near our new Crown Point office, then please stop by. We hope that you will keep our firm in mind for your legal needs as 2012 comes to a close and we head into 2013.

Geoff Bryce
Managing Member

I'm Covered By Insurance If The Roof Leaks, Right?

By Geoffrey A. Bryce

Assume these facts. An owner of a building, factory or facility decides to build a new facility or expand an existing facility. The owner carefully selects a design professional to design the project and carefully selects a general contractor. The facility is designed and built; six months later, the roof leaks. The owner calls the general contractor! "Please fix my roof immediately!" The general contractor calls the roofing subcontractor: you need to fix this- now!" The roofing subcontractor tries to fix the problem, but is unsuccessful. The owner hires a new design professional and the engineer discovers the roofer used nails instead of bolts to anchor the roof edge detail. Both the general contractor and the roofer say "we are sorry, but we don't have the financial resources to fix your problem."

The owner sues the general contractor, who tenders the defense of the owner's suit to its insurance carrier. The President of the general contractor says "I'm covered by insurance for these roof leaks, right?" The carrier denies coverage and sues the general contractor seeking a declaration by the court that there is no insurance coverage. In Illinois, courts would generally find that the general contractor must defend itself and pay the owner for any repairs.

Illinois Law is unlike other states, like for example Wisconsin [1] and Indiana[2]. In those states the general contractor would be covered for this claim. However, in Illinois there is no comprehensive general liability ("CGL") insurance coverage for construction defects. The recent Seventh Circuit Court of Appeals decision *Lagestee-Mulder, Inc. v. Consolidated Insurance Company* 682 Fed. 2d 1054 (C.A. 7 2012) states:

[1] *American Girl, Inc. v. American Family Mutual Insurance*, 268 Wis.2d 16, 673 N.W.2d 65(Wisc. 2004)
[2] *Sheehan Construction Company v. Continental Insurance Company*, 935 N.E.2d 160 (Ind.2010)

"The rules governing application of CGL policy provisions are settled. Where the underlying suit alleges damage to the construction project itself because of a construction defect, there is no coverage. By contrast, where the complaint alleges that a construction defect damaged something other than the project, coverage exists".

In many construction defect cases the allegations of the complaint merely seek repair and replacement costs to correct the construction defect (i.e., in this case - fix the leaky roof, or fix the leaky curtain wall, or reattach sagging balconies etc.) Under Illinois Law there is no coverage. The reason is that insurance coverage is not intended to be a performance bond guaranteeing contractor workmanship. The Seventh Circuit stated the reason for this rule as follows:

"Comprehensive general liability policies… are intended to protect the insured from liability for injury or damage to the persons or property of others; they are not intended to pay the costs associated with repairing or replacing the insured's defective work and products, which are purely economic losses. Finding coverage for the cost of replacing or repairing defective work would transform the policy into something akin to a performance bond".

That is not to say all construction defect cases are not covered. If the allegations of the complaint allege damage to the property rather than the building itself, like for example, the personal property of the occupants, then there is insurance coverage for the damage to the other property.

My Real Estate Taxes Keep Going Up! Help!!

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Cook County, many towns and villages, and some school districts are in difficult financial positions. As a result, each of these taxing bodies is looking for ways to raise revenue.

Three components make up Cook County real estate taxes.

. amount sought by local taxing bodies
. state real estate tax multiplier
. assessed value of the property

LOCAL TAXING BODIES. Depending upon the town that you live in, there may be as many as 16 taxing bodies (e.g., the grade school, the high school, park district, village or town, library, park district, Cook County, Cook County Public Safety, etc.) that seek funds for the services they provide to the residents. Each of these taxing bodies prepares a budget, which is used to determine the tax rate for the particular taxing body. For example, the high school superintendent prepares the local high school budget, which is submitted to the elected school board members. After review and discussion, the school board approves the budget. The tax rate is calculated based on the amount that was approved by the school board. On your most recent real estate tax bill, compare the current rates with the previous year's rates. For example, on the tax bill receive in August 2012, the Village of Flossmoor (a suburb of Chicago) residents saw the Cook County, municipalities/townships, and school districts increase their rates from 11.574 to 14.615, which was a 26% increase. Also, Cook County added "Consolidated Elections" as a taxing body. Previously the money for elections came from taxes allocated to Cook County operations. If you think the amount of taxes being sought is too high, then residents need to demand that local school board and other local officials be more fiscally responsible.

STATE REAL ESTATE TAX MULTIPLIER. The multiplier is approved by our elected officials in Springfield. On real estate tax bills sent out in November, 2011; the state multiplier skyrocketed from 2.97 to 3.37, which was a 13.5% increase! On real estate tax bills received in August 2012, the multiplier returned to 2.97; however, local taxing bodies increased their tax rates as described above.

ASSESSED VALUE. The assessed value of your property is determined by the assessor's office. Every third year, property owners receive a statement from the Assessor indicating the past and new assessed valuation. There are many components that determine the assessed valuation, but square footage of the building is the key factor. Another important factor is the square footage of the land.

RESIDENTIAL

When a homeowner receives the notice from the Assessor's Office, you have an opportunity to appeal the determination. You can appeal the Assessor's amount under various theories, including lack of uniformity. Lack of uniformity happens when your neighbor's home is larger and is on a larger lot, but it has a lower assessed valuation. You can find information about your home and other homes in your neighborhood on the Assessor's web-site at www.cookcountyassessor.com . The appeal form, which is also on the web, requires you to provide your name, address, and the property tax number ("PIN") for your home. List on the appeal the PIN's for three of your neighbor's homes that are larger than yours, but that have lower assessed values. You should receive a determination within six weeks or so. If you don't like the results, then you can file an appeal with the Cook County Board of Review. Both the Assessor's Office and the Board of Review hear appeals for the various neighborhoods during certain times of the year. Again, if you look on the web-site, you can determine when the Assessor and the Board of Review are accepting appeals for your neighborhood.

COMMERCIAL AND INDUSTRIAL

Commercial and Industrial properties are assessed in similar manners as residential. However, appeals for these properties generally involve an appraisal by a licensed MAI Appraiser. The appraiser will inspect the property and do a search of other properties in the general area. The appraiser will analyze the property under three methods: sales comparison approach (estimate of value that compares the property with similar properties that have recently sold and have similar characteristics or indicators of value); cost approach (cost to construct the building less estimated depreciation); and the income approach (how much cash flow is generated). After making the calculations, the Appraiser provides an overall value. Once this amount is determined, then the assessed valuation can be determined by multiplying the market value of the property by 25% for industrial and commercial properties.

The appraisal is attached as one of the documents that are submitted to the Assessor or the Board of Review in order to determine whether the assessed valuation will be adjusted. After submitting your appeal to either the Assessor or the Board of Review, you will normally receive a determination within 6 to 8 weeks. If an appeal is made with the Board of Review, the appellant has the opportunity to make an oral argument.

Recently, we represented a **commercial client** before the Board of Review. The building was used solely by the owner for its business. Due to the economy, the net income for the past few years was down, and there were several buildings in the neighborhood that had recently become vacant. After we presented our case that the property was overvalued, the Board of Review decreased the assessed valuation by 28%. Even with the increase in the state multiplier, the client's real estate taxes were substantially lower than in the prior year.

This past summer, we represented an **industrial client** with respect to an appeal before the Cook County Assessor. The plant was used solely by the

owner for its business. Although the client's business has been solid throughout the last few years, the client decided to appeal. The same appraiser, who did the appraisal three years ago, found that the appraised value of the plant had decreased by 8%. After we presented our argument that the property was overvalued, the Assessor decreased the assessed valuation by 31%

Pollution and Contamination: My Policy's Pollution Exclusion Excludes Coverage for That?

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Test Question:

Coverage for the following is excluded by your general liability or property insurance policy's Pollution and Contamination Exclusion:

a. damage to property resulting from hazardous substances leaking from an underground storage tank
b. bodily injury resulting from the accidental discharge of methylene chloride into public drinking water
c. damage to property (retail clothing) resulting from the curry aroma wafting over from the Indian restaurant next door
d. a and b only
e. a, b and c above.

If you are under the impression that your policy's pollution exclusion excludes coverage solely for what are deemed "traditional pollution claims", you are most likely to select answer "d", which obviously deals with claims for the type of "pollution" or "contamination" that the pollution exclusion was originally designed to address. The correct answer is "e". Curry odor, thought to be a pollutant by most people, would be excluded under the policy.

In *Maxine Furs, Inc. v. Auto-Owners Ins. Co.*, 426 F. App'x 687 (11th Cir. 2011), plaintiff's fur shop happened to be next door to an Indian restaurant, and their spaces shared air-conditioning ducts. When plaintiff's furs began to smell like curry, plaintiff had the affected furs cleaned and then submitted the claim to its insurer. The insurer denied coverage based on the policy's absolute pollution exclusion, so plaintiff sued the insurer for breach of the insurance contract. The court held in favor of the insurer, finding that the policy excludes from coverage any damage or loss caused by "discharge, dispersal, seepage, migration, release or escape of pollutants." The policy defined pollutant as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Aided by *Webster's Dictionary*, which defines "contaminant" as something that "soil[s], stain[s], corrupt[s], or infect[s] by contact or association", the court concluded that curry aroma was a "contaminant" and upheld the insurer's denial of coverage.

The "curried fur" case is just one example from an increasing number of insurance coverage cases decided over the last few years where courts have construed the "absolute pollution exclusion" as in fact "absolute", and encompassing a variety of claims nowhere akin to the dumping or spilling of noxious chemicals or other clearly "hazardous" substances. In light of this broadening scope of claims coming within the exclusion, it may be worth investigating the purchase of environmental coverage for your business, even if your business is not one that has traditionally been considered "at risk" for exposure to "environmental" claims.

Title Company Takes Hit For Failing To Defend Against Mechanics Lien Claim

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The "created or suffered" exclusion is a standard provision in title insurance contracts, but it is one of the most litigated provisions in the construction field. The United States Court of Appeals for the Seventh Circuit recently, and for the first time under Indiana law, interpreted the provision to find that it did not apply to a title company's claim that it had no obligation to defend its insured against a mechanics lien claim.

The case, *Home Federal Savings Bank v. Ticor Title Insurance Company*, originated out of a bank's commitment to loan $95.5 million to a developer for the construction of an ethanol plant. To secure its loan, the bank obtained a mortgage on the property and, to protect its mortgage, the bank obtained title insurance from the title company. Under the title insurance policy, the title company was to perform a title search after each disbursement the bank made to insure against any loss the bank might incur due to "lack of priority of [the mortgage] over any [mechanics lien]." The bank obtained an additional mechanics lien endorsement to insure against "the enforcement or attempted enforcement of any [mechanics lien] . . . arising from construction contracted for and/or commenced on the land prior to, at or subsequent to the effective date" of the title insurance policy. The title insurance policy, however, contained a provision under which coverage for claims "created, suffered, assumed or agreed to" by the insured, would be excluded.

After more than $87 million of the loan proceeds had been disbursed and accounted for through lien waivers the bank had collected, the developer defaulted on the loan and the general contractor filed a mechanics lien claiming it was owed $6 million for work performed on the property. The bank filed suit to foreclose its mortgage and the general contractor asserted a counterclaim seeking to foreclose its mechanics lien alleging, among other things, that the mechanics lien had priority over the mortgage. The bank tendered the claim to the title company but the title company denied it was obligated to provide either a defense or indemnification for the claim.

One of the arguments made by the title company in support of its position was that the "created or suffered" exclusion applied because the bank purportedly "created, suffered, assumed or agreed" to the mechanics lien because it made the conscious decision to not distribute remaining loan proceeds to pay the general contractor. Or, in other words, "but-for" the bank's failure to pay the general contractor, the general contractor would not have filed a mechanics lien or asserted a counterclaim alleging the lien had priority over the mortgage.

The Court ultimately rejected this argument and held that the "created or suffered" exclusion should be defined to apply only to *intentional misconduct, breach of duty or otherwise inequitable dealings* by the insured. Although the title company argued that the bank breached a duty to the title company to distribute the entirety of the loan proceeds, the Court found that no such duty existed. Specifically, the Court held that there was nothing in the title insurance policy or the course of dealings between the parties to indicate that the bank was bound to disburse the entirety of its loan commitment to the developer even if the developer was in default. Because the bank had no obligation to continue funding, the bank owed no duty – express or implied – to disburse the entire amount of its loan commitment to pay contractors.

The title company then argued that the exclusion should still apply because it would be inequitable to allow the bank to obtain a windfall by first refusing to pay the general contractor and then seeking to recover on the title insurance policy. The Court again rejected the argument initially pointing out the fact that the bank had no obligation to pay the general contractor directly. The Court further found that the general

contractor's mechanics lien was a risk the title company specifically agreed to insure under the mechanics lien endorsement because it arose from construction either contracted for or commenced *subsequent to* the effective date of the title insurance policy.

Online Collaboration Platforms: Bringing The Business of Construction Into the 21ST Century

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Imagine using horses to pull construction materials across work sites, or wooden rollers to move block of concrete on today's construction sites. Clearly, these are the images of days long past in the construction industry. Back-breaking labor has been replaced with technological advances which have made construction development a much easier task. However, while technology has vastly improved the means and methods of construction, the business of the industry remains trapped deep in the previous century. With owners, general contractors, and subcontractors mired in paperwork and manual processing, an efficient, accessible, and accurate solution is emerging which seems ready to take hold.

The answer may lie in new software solutions involving online collaboration platforms. Led by innovators such as Textura Corporation in Illinois, there is now a push to both update and streamline the processes of pre-qualification, invoicing, lien waiver collection, and contractor payments all on one computer software platform. Textura Corporation has been serving customers in the construction industry since 2004 with over 16,000 current users representing 7,500 organizations all across the country. They have developed software that allows all parties on the construction project to meet in a centralized location which is accessible to anyone with a computer and an internet connection. The software also minimizes the human-error element of manually processing. The benefits are clear, but are better illustrated when viewed according to each phase of construction.

The pre-qualification process is often vexing for even the most seasoned of construction company executives. Performed manually, each packet of pre-qualification forms can take 2-3 hours of diligent preparation. Online Collaboration Platforms such as that developed by Textura, offer a web-based Pre-Qualification Management (PQM) which can significantly reduce completion time by loading a GC's pre-qualification forms into the program's forms library which then requires only data filling. The capability of electronic submission, review, approval and updating of all pre-qualification documents allows subcontractors to reallocate human resources away from paperwork and towards performance and increased bidding opportunities. General contractors are able to quickly assess which contractors "make the grade" and which do not. References, insurance, surety and bank information can be easily reviewed and analyzed with user-friendly accuracy. Software like Textura's PQM is a solution that assists all the parties in the process.

How can the typical GC reduce its payment cycle by up to two (2) weeks while also reducing administrative and finance costs by 20 percent? The development of online invoicing and electronic payment systems has vastly improved the speed and accuracy of the payment process. From the initiation of the draw to the final resolution of the invoice, the sheer volume of collecting, reviewing, and paying invoices can frustrate most general contractors on the front-end and subcontractors on the receiving end. How is this done? Textura software allows the GC to invite all participants to the draw via email. The subcontractor (or supplier) can then access the schedule of values by clicking a hyperlink in the system generated email, and enter requested payment amounts or change orders. The GC then can review the invoices online and when approved, can create an owner pay application complete with

electronic signatures. Now held in a centralized database, the entirety of the GC documents can be reviewed by on-system owners, architects, lenders, or title companies. The real advantage to the software is manifest when prior to disbursement, the GC can request that all subcontractors sign their unconditional lien waivers in the system. Once completed, the GC clicks a button to disperse funds and the system creates a payment file which is securely transmitted to the GC's bank for processing. After the subcontractor has been paid, the program releases the signed lien waivers to the GC. A process that usually took a week or more can now be affected in a 24-hour turn-around cycle.

Another advantage to online collaboration platforms is the reduction of risk involving Prime Subcontractor default and verifying sub-tier contractor payments. It is well established in the industry that if the GC does not completely and accurately collect lien waivers, the entire project is exposed to the risk of liens by subs and suppliers who have not been paid for work or materials. More critically, GC's are at-risk when sub-tiers are not paid and are often forced to pay those sub-tiers,

even if the Prime Subcontractor has received payment. How can the GC better manage the task of obtaining all sub-tier and supplier information from each Prime Subcontractor for each draw period, and then accurately withhold payments to Prime Subs until all sub-tier lien waivers are collected? Indicative of the pretechnology state of construction, GC's presently manage this process manually or with elaborate spreadsheets. This method is inherently exposed to inefficiency and human error.

What Textura, and companies like it, have accomplished is automating this entire process. Prime Subs can submit their Contractor and Material Supplier information from all subcontractors via Textura CPM (Construction Payment Management) at the very beginning of the project. After entering each invoice onto CPM, Prime Subs can update the information to reflect change orders and the system simultaneously updates the GC's master tracking matrix and informs all users which sub-tier lien waivers should be collected. Textura CPM software then tracks sub-tier lien requirements by affixing Contractor Affidavits for each signed waiver. The sub-tier lien waivers that are collected electronically are then verified when received, scanned, and available for uploading to make all draw documents and attachments available in one convenient, central location.

The most important innovation however is that CPM automatically withholds sub payments by identifying missing or incorrect lien waivers. This prompts the system to place a hold on payments to the Prime Subcontractor. Once all the overdue lien waivers have been collected and the compliance status of the subcontractor is verified, payment holds are released and disbursed appropriately. Moreover, all parties have the same up-to-date information at their fingertips at all times. A Prime Subcontractor can even access that GC's master tracking date to view their current compliance status at any time. Prime subcontractor default, unfortunately, is a reality in today's economy. Any effective means of collecting, tracking, and verifying sub-tier lien waivers is a tremendous advancement for all parties involved. This is particularly true for companies that operate in multiple states where each state has its own unique lien waiver requirements.

Through the use and continued development of online collaboration platforms, we are now living in an age where the construction industry may indeed benefit from the technology revolution.

Bryce Downey & Lenkov is a firm of experienced business counselors and accomplished trial lawyers who deliver service, success and satisfaction. We exceed clients' expectations while providing the highest caliber of service in a wide range of practice areas. With offices in Chicago, Merrillville, IN, Memphis and Atlanta and attorneys licensed in multiple states, Bryce Downey & Lenkov is able to serve its clients' needs with a regional concentration while maintaining a national practice. Our practice areas include:

Business Litigation Business Transactions/Counseling Corporate/LLC/Partnership Organization and Governance	Construction Employment and Labor Environmental Law Insurance Coverage	Insurance Litigation Intellectual Property Medical Malpractice	Professional Liability Real Estate Workers' Compensation

The attorneys at Bryce Downey & Lenkov are committed to keeping you updated regarding the latest developments in corporate and construction law in Illinois and Indiana. If you would like more information on any of the topics discussed above, or have any questions regarding these issues, please contact Geoff Bryce 312.377.1501 or gbryce@brycedowney.com.

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