

**Illinois Mechanics Lien Priorities Causes the Death of a Good Man**

Imagine the year is 2011 and you are the president of a construction subcontractor performing work in Illinois. As you fret over a project in which the owner is experiencing financial difficulties, you worry that your company may not be paid for all the excellent work it has performed and you envisage the project set against a dark and stormy sky amidst a torrential downpour, sitting precariously atop a rocky atoll in a barren land, silhouetted against the night sky by the frequent lightning strikes. A chill comes over you as you silently curse your vivid imagination.

Before the heebie-jeebies completely take over your mind, you forcibly shift your focus to a rational evaluation of your circumstances. You take some comfort in knowing that all of your work is of high quality. The storm begins to abate. The project is near completion and is on schedule. The sun begins to shine. And then you remember that this is Illinois and in the case of a foreclosure, your mechanics lien rights give you priority over the mortgage of the construction lender with regard to the work you have performed. The sun shines brightly and the project is transported back to its rightful location. Hooray for the Illinois legislature!!! A rare thought indeed.

As your heart rate returns to normal, you pick up a trade journal and read about the Illinois Supreme Court's decision in LaSalle Bank v. Cypress Creek, 242 Ill.2d 231 (2011). As you read, the sky again darkens, the rain starts to fall and the building is again set in the barren landscape. As you read further, the ground opens up, crumbling the project and sucking it down into the gaping chasm. Panic takes control, your heart hammers painfully in your chest and then you die. Thanks very much Illinois Supreme Court - for killing me!

In case you have erased Cypress Creek from your mind, a reminder that before the Cypress Creek decision, contractors interpreting Section 16 of the Mechanics Lien Act believed that they had priority over preexisting mortgages to the extent of the value of the improvements made, because that is what the Act said. Specifically, the pertinent part of Section 16 stated

...upon questions arising between incumbrancers and lien creditors, all previous incumbrances shall be preferred to the extent of the value of the land at the time of making of the contract and the lien creditor shall be preferred to the value of the improvements erected on said premises...

Cypress Creek was a dispute between two subcontractors and the project lender. The case held that a lender's mortgage had priority over the mechanics liens of the contractors (the general contractor and all of its subcontractors), not only for the value of the land, but also for the value of all improvements for which payment had been made from the construction loan. In other words, the lender was put on equal footing with the contractors with regard to all improvements paid for with the loan. In determining the priority of distribution of foreclosure proceeds, Cypress Creek held that each contractor was entitled to priority only for the value of its own work, not the work of all contractors. If foreclosure proceeds were of insufficient value to pay all claimants, under Cypress Creek, a significantly greater share of the proceeds were paid to the construction lender to the detriment of the contractors.

Fortunately, the havoc wrought by Cypress Creek was corrected by the again heroic Illinois legislature and their sword of justice, Senate Bill 3636, passed into law on February 11, 2013 and now codified as an amendment to Section 16 of the Mechanics Lien Act. The change left no doubt that mechanics lien creditors are to be preferred over construction lenders with regard to the value of all improvements erected on the premises after the lender's mortgage has been recorded, not just the improvements made by each lien claimant, and that construction lenders have preference only with regard to the value of the property and existing improvements at the time the mortgage is recorded.

All would be well and good for contractors in the land of Illinois after passage of S. B. 3636, except that lenders understandably liked the priorities established by Cypress Creek and tried to find alternatives to get them back. Illinois law did not allow a contractor to waive its mechanics lien rights in anticipation of or consideration for the awarding of a contract, but it did allow voluntary subordination. In other words, a contractor could, by written agreement, give the lender's mortgage priority over the contractor's lien rights.

Subordination was not new, but after the legislative repeal of Cypress Creek there was increased pressure by lenders on owners and owners in turn on contractors to subordinate mechanics lien rights. This brings our story to the most recent heroic act of the Illinois legislature, wherein the legislators are more Solomon than Lancelot. Upset with repeated demands to subordinate their lien rights, the contracting community lobbied our hero to again sally forth (to leave a safe place to face danger – not the comic strip) in defense of the construction industry. Specifically, contractors lobbied the legislature to treat subordination of lien rights like waivers of lien rights – to make them unenforceable if given in anticipation and consideration for the award of a contract or subcontract. This time, the lending community also flexed its muscle in opposition to the proposed change. The result, Senate Bill 3023, enacted into law on July 16, 2014, was a compromise. The law declares that an agreement to subordinate a mechanics lien to a mortgage securing a construction loan is against public policy and unenforceable unless the agreement to subordinate is made after more than 50 percent of the construction loan has been disbursed to fund improvements to the property.

It may seem that the Legislature reached a true compromise, but further examination reveals that this change again favors contractors. Because the agreement to subordinate may not be made until after the loan is half funded, it cannot be in the construction agreement entered into between the owner and contractor at the start of the project. Whether lenders will successfully use the change in law to their advantage has yet to be seen. Only time will tell if the Illinois legislature is provided with an opportunity to one day enact another Cypress Creek related amendment, thereby completing the Cypress Creek Trilogy.

*Benjamin A. Johnston, a 2015 Leading Lawyer, practices in the area of construction law as special counsel in the Chicago office of Duane Morris, LLP. Duane Morris has over 700 attorneys across the United States and internationally. The firm's construction litigation practice has been rated the best in the United States for the past 3 consecutive years.*