Pay If Paid Clause—Alive and Well

By: Alan Stefaniak

When a subcontractor or material supplier enters a contract there are many contract provisions that are of concern. One of the most problematic is the pay when paid provision. Most general contractor form contracts have such a provision and under Illinois law it is enforceable. In essence this provision shifts the risk of an owner’s insolvency to the subcontractor since it provides that the general contractor only has to pay the sub if the general receives payment from the owner. A recent Seventh Circuit US Court of Appeals decision reaffirms that such a provision is enforceable and can have severe consequences to a subcontractor or material supplier.

The general contractor was under contract with the owner to construct a manufacturing plant near Indianapolis, Indiana. After about a year of construction the owner went bankrupt. There was significant money owed. $40 million to the general contractor, $11 million to a subcontractor and $1.5 million to a sub-subcontractor. The subcontractor’s contract had a pay if paid clause. The sub-subcontractor perfected its mechanic’s lien rights and recovered about half of its money in the owner’s bankruptcy proceedings when the property was sold. A lawsuit was filed by the sub-subcontractor on the payment bond that had been provided by the subcontractor to the general.

The dispute in the lawsuit was whether the clause at issue was a true pay if paid clause or a pay when paid provision. Also at issue was whether the bonding company could assert the pay if paid clause as a defense to the action on the payment bond.

There was little question by the US Court of Appeals that the provision at issue was a pay if paid clause. It provided as follows: “IT IS EXPRESSLY AGREED THAT OWNER’S ACCEPTANCE OF SUBCONTRACTOR’S WORK AND PAYMENT TO THE CONTRACTOR

The Appellate Court held this language was clearly a pay if paid provision and that by agreeing to it the sub-subcontractor assumed the risk of the owner’s insolvency.

The sub-subcontractor argued that because the payment bond did not expressly incorporate the terms of the sub-subcontract that had the pay if paid provision the bonding company could be held liable even though the subcontractor could not be under the contract. The Appellate Court rejected this argument as it contradicts basic principles of surety law. The bonding company is only liable to answer for the debts of its principal and if the principal is not liable then neither is the bonding company. Accordingly, the sub-subcontractor could not recover the balance of its money from either the subcontractor with whom it contracted nor the bonding company.

The decision in this case highlights the importance of perfecting your mechanic’s lien rights. While this case involved Indiana law the law in Illinois is the same. A pay if paid clause in a contract is not a defense to a mechanic’s lien claim. It is a defense to a contract claim. Had the sub-subcontractor not perfected its lien rights that allowed it to recover half of its money in the owner’s bankruptcy it would have lost the entire $1.5 million it was owed. Don’t think that just because a payment bond is in place you are safe. The bonding company has all the defenses that its principal has under the contract at issue. Make sure you understand the consequences of a pay if paid clause and always take action soon enough to perfect your lien rights.

Mr. Stefaniak publishes by email a monthly newsletter devoted to topics in his areas of concentration "Construction, Land Use and Development Update." If you would like to be added to the subscriber list send your email address to mmulvany@dimontelaw.com.
Tips for Hiring a Nanny
By: Linscott R. Hanson

Summertime. When my children were little and summer rolled around, we used to get someone we called a “summer girl” to come stay with us for the summer, be an activity director for the children, and give us a little time to ourselves. Now I think they’re called Nannies, and sometimes they’re hired on a year around basis. Nannies aren’t all about fun, games and free time, you have to be aware of the legal, tax and other issues involved. Here are some of the most common issues that families should understand before hiring a childcare provider.

Independent Contractor vs. Employee?
Workers classified as independent contractors set their own hours, and can generally work however they choose to get the job done. For a Nanny to be classified as an independent contractor, she would have to set her own schedule (doesn’t work well for someone who is hired to take care of your children), be available to the general public, and may finish a job any way she wishes, without review of the process by the family she works for.

Many businesses are concerned with the distinction between independent contractors (no withholding, no overtime pay, etc.) and employees. A Nanny is almost always considered an employee. Since the family designates the hours the Nanny must work, as well as specific tasks and other household chores she is to perform, a Nanny would usually not meet the requirements for classification as an independent contractor.

Pay and Overtime Pay
You and the Nanny should be specific about the rate of pay (remember minimum wage applies) for the Nanny, and when payments will be made. Will you be providing any Fringe benefits, such as health insurance or workers compensation insurance? Will the Nanny be living in your home? Provided with Afters meals? Have her own bedroom? TV? Computer? Access to your telephone? All household employees, including nannies, must be paid for overtime work under federal law unless they live in your home. Any time she works more than 40 hours within a 7 day week you must pay her an hourly rate that is 1.5 times her regular hourly wage. However, there may be other forms of compensation.

Work Eligibility
Before a Nanny starts work, ask her to complete an AI-9” Employment Eligibility Verification form. Read the directions on the form and verify the Nanny’s proof of employment eligibility. The prospective Nanny should be ready to show a combination of documents as evidence of her ability to work legally in the U.S. Documents can include a Social Security card, driver’s license, birth certificate, passport, green card, or work permit, or combination thereof. You should make copies of these documents and keep them in your records along with the completed I-9 form.

Additionally you will undoubtedly want to ask applicants for references, check those references, and do a background check on applicants before making a final hiring decision.

Qualifications
You probably will want your Nanny to complete First-Aid and CPR training. It may be necessary for you to pay the cost of this training, and to find the most convenient place where it can occur. You may even have to provide transportation for the training, but if you consider it important, its just part of the cost of obtaining Nanny care.

Tax Responsibilities
If your Nanny is paid at least $1,500 a year, you must contribute to Social Security and Medicare. You pay for half of the Social Security taxes and deduct the other half from the Nanny’s pay check. You may choose to withhold income taxes as well, although it is optional. However, it’s usually more convenient for the household worker for you to withhold. When your Nanny starts employment, ask her to complete a W-4 form so you know how much to withhold from her pay. You’ll also need to issue a W-2 form to her every year so she can report her income when she files her tax return. You are required to withhold tax and social security tax and remit these on a regular basis just as businesses do with their employees. There is personal liability to the IRS for failure to do so.

Creating an Employment Agreement
When you hire your Nanny, it is a good idea to have a comprehensive Nanny-Family Employment Agreement. This document will include state guidelines such as the hours the Nanny will work, how much and when she will be paid, a description of her basic duties, and conditions and procedures for termination. You may also want to include additional duties and guidelines for confidentiality. Your DiMonte & Lizak, LLC attorney can provide you with such an agreement if you wish.

Automobile
Will it be necessary for your Nanny to have a car to perform her duties? Will you allow her to use one of yours, or require her to provide her own? You need to be sure she is licensed to drive. Insurance - is she providing insurance, or will she be covered under your policy? What will that do to your insurance rates? Will she be permitted some limited use of your car when she is on her own time? Will there be restrictions on such use?

Restrictions
You need to be clear, and make it a part of the contract, on use of substances while in the home. Restrictions on such use?

Speaking Engagements
We are proud to report that several Di Monte & Lizak attorneys recently gave presentations on various legal issues.

- Margherita M. Albarello and Julia Jensen Smolka shared their legal expertise at a Park Ridge Chamber of Commerce Women In Business section event. Margherita spoke on the topic of how to tell whether you are an independent contractor or an employee. Julia spoke at the event about collecting accounts receivable.

- Alan L. Stefaniak was a featured speaker at a seminar put on by the National Business Institute on Zoning and Land Use on August 8, 2012 and his topics included “What is the Comprehensive Plan and How to Use It” and also “Annexation”.

If you are interested in more information on any of these topics, please feel free to contact these attorneys.
When you hear the term social media what do you think about? If your only thought is Facebook, you may have a problem. Social media is the future and the present. Social media affects your business everyday: from an employee tweeting a complaint about an employer, to a customer expressing a complaint on Yelp. It has become increasingly important for businesses to control their brand in the world of social media. Equally important is avoiding the legal pitfalls in this widely unchartered area of the law. This article will discuss a couple tips for you to consider as your business becomes increasingly intertwined with social media.

**Create A Social Media Policy.**

Section 7 of the National Labor Relations Act protects the activity of employees related to the improvement of labor conditions. Section 7’s protection is very broad. Thus, a Facebook post that reads, “only given 30 minutes for lunch today at work, not fair”, is protected activity. On May 30, 2012, the General Counsel of the National Labor Relations Board (hereinafter the “NLRB”) issued a memo in an attempt to clarify how an employer may control an employee’s social media interaction. This article is not a substitute for the 26 page NLRB memo. Read the memo, or consult counsel before drafting any social media policies. In the interim, here are some things you should consider: First, make sure your employees read your social media policy. Second, your employees are not your spokesmen; make sure they know this when interacting on social media. Third, protect your business by restricting your employee from posting confidential information. Be aware that some confidential information, such as salary and bonuses is protected by the Act and likely may not be restricted via a social media policy. Fourth, prohibit the use of social media at work unless it is work related. Lastly, remain diligent in staying up to date on social media policy as it is constantly evolving.

**Tread Cautiously When Interacting With Employees and Prospective Employees through Social Media.**

You can learn a lot about your employee or prospective employee by accessing their Facebook, Twitter, or LinkedIn account. Likewise, your business may derive a benefit from using an employee’s social media account. However, both of the above activities may expose you and your business to civil and possibly criminal liability. In a recent decision the Northern District of Illinois, found that an employer’s use of its employees Facebook and Twitter accounts were sufficient to allege a false endorsement claim under the Lanham Act. Maremont v. Susan Fredman Design Group, Ltd., 772 F. Supp. 2d 967, 970 (N.D. Ill. 2011). Under the Lanham Act, “false endorsement occurs when a person’s identity is connected with a product or service in such a way that consumers are likely to be misled about that person’s sponsorship or approval of the product or service.” Id. 15 U.S.C. §1125(a)(1)(A). Proven violations of the Lanham Act award the winning party treble damages. In another Facebook faux pas, a law firm representing an insurance company hired a private investigator to become Facebook friends with a minor to assess her damages resulting from a dog bite. The private investigator, the law firm, and the insurance company are all being sued by the family of the minor for allegedly violating sections 18 U.S.C. § 2707, and § 2701 of the Stored Communications Act. The Act, which was enacted to prevent abuse of access to stored electronic communications (think emails and text messages), carries with it both civil and criminal penalties.

Lastly, a lawyer and his client in the Commonwealth of Virginia recently encountered the trappings of Facebook malefascense when a judge found their conduct sanctionable to the tune of $722,000.00 and a reduced jury verdict award from $6,227,000 to $2,100,000. The basis of this sanction was that Plaintiff’s counsel directed his client to “clean up” his Facebook page. The Plaintiff thereafter deleted photos from his Facebook page which depicted him in a jovial state. These pictures were relevant to the litigation because the Plaintiff’s wife had recently died in a car accident and the pain endured by the Plaintiff in losing his wife was significant in awarding damages.

**What To Take From All This?**

Social media is big, fast moving, and whether you like it or not, a part of your business. Unfortunately, the law cannot keep up with the ever changing medium of social media; what is true today may be obsolete tomorrow. All you can do is remain vigilant, consult counsel before making any social media related decisions, and when all else fails, err on the side of caution.

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**Surety Bonds: A Hidden Cost of Probate – continued from front page**

Surety on the bond. In such cases, Illinois law requires the amount of the bond to be at least 150% of the value of the decedent’s personal estate (i.e. excluding the value of real estate). Because real estate cannot be easily stolen, the bond does not need to include the value of the real estate. For example, a representative of an estate comprised of a house valued at $300,000.00 and bank accounts and stock investments valued at $500,000.00 would be required to post a surety bond of $750,000.00, which is 150% of the value of the bank accounts and stock investments.

Of course, the surety company issuing the bond does not undertake this risk without underwriting or compensation. Bond companies routinely check the credit and background of the bonded individual prior to issuing a surety bond. The larger the estate, the more thorough the credit and background check will be. Premiums on surety bonds are based upon the amount of the surety bond paid annually to surety companies out of the assets of the estate.

_How can you avoid the expense of surety bonds?_ Surety bonds are generally required in all probate estates, but can be avoided in certain cases. Because the cost of surety bonds are paid out of the estate’s assets, the heirs’ beneficiaries’ distributive share of the estate is reduced by the amounts paid for surety bond premiums. Avoiding the need to post a surety bond can result in substantial cost savings for the estate.

The simplest way to avoid the expense of a surety bond is for the decedent to have waived the requirement of giving bond or surety in a valid Last Will and Testament. In most cases, the ability to avoid the expense of a surety bond is a sufficient reason to have a will drafted, even if the will directs distribution of the estate exactly as it would be under the laws of descent and distribution.

Some states allow bond to be waived in intestate estates if all of the heirs are adults and each of them agrees to waive the requirement of bond. Illinois does not.

As an alternative, Illinois law allows the representative to deposit some or all of the assets of the estate with a qualified corporate trust company. Those assets so deposited are not included in the calculation of the representative’s bond. However, the corporate trust company will charge management fees, which could offset any savings achieved by avoiding or reducing the surety bond.

Similarly, when a qualified corporate trust company is acting as representative, bond is not usually required. The reasoning behind this exception and the exception discussed in the previous paragraph is that corporate fiduciaries are much less likely to embezzle their client’s money and, if they do, the companies’ capitalization requirements ensure that there are enough assets to pursue. Of course, as with the deposits discussed in the previous paragraph, the corporate trust company will charge management fees to the estate, which could offset any savings.

In conclusion, if probate is necessary, the best way to avoid the expense of a surety bond is to ensure that your will waives the statutory requirement for your executor to give bond or surety. If you do not make a will that waives surety on the executor’s bond, you are only ensuring that your heirs are going to be forced to bear the cost of a surety bond.
A surety bond is a written commitment by a surety to another party, called the obligee, guaranteeing the performance of a person or entity, called the principal, under a specific contract or legal obligation. The bond protects the obligee in the event the principal fails to fulfill its responsibilities as outlined in the bond agreement.

In the context of estate administration, a surety bond is often required for the personal representative (executor or administrator) of a probate estate. The bond ensures that the representative will carry out their duties honestly and according to Illinois' laws of descent and distribution. To ensure that an executor or administrator performs these tasks honestly, Illinois' Probate Act requires that the representative file a bond binding the representative to collect all of the decedent's probate assets, file the decedent's final income tax return, pay the claims filed against the estate and distribute the remaining assets to the decedent's heirs or legatees, according to the decedent's will.

A surety bond acts like an insurance policy for the loss, up to the amount of the bond, should the obligee suffer a loss due to the principal's failure to perform. The surety issuing the bond would be responsible for the loss, up to the amount of the bond, thereby protecting the obligee. Should the bonded representative fail to perform their duties, the surety would take over the principal's responsibilities and use the bond proceeds to pay any valid claims against the estate.

In essence, the surety bond ensures the obligee will not suffer a loss due to the principal's failure to perform, by substituting the obligations of the surety for the principal. This is an example of the shift of legal risk from one party to another.