

Brown & Ruprecht, PC Successfully Navigates the Corbin Park Storm

The recent recession has left a number of construction projects in the Kansas City metropolitan area uncompleted, and has left many banks, contractors, subcontractors and suppliers unpaid in its wake. One such project is the Corbin Park development at 135th & Metcalf in Overland Park, Kansas. Litigation involving Corbin Park is pending in both the U.S. Bankruptcy Court and the U.S. District Court for the District of Kansas, and the outcomes of the cases already promise to impact a subcontractor's ability to receive payment for work performed in Kansas.

The Corbin Park development began in 2004, but by early 2008, the owner-developer could no longer fund the project. A new corporation was formed, and ownership of the project was transferred to the new entity for the purpose of securing new funding. The former owner advised the subcontractors of the impending ownership change, closed out contracts with the subcontractors, and paid the unpaid subcontractors' bills out of the proceeds from the closing. Subcontractors were advised they would be required to enter into new contracts with the new owner to continue work on the project, and many did so. Eventually, however, the new owner could no longer finance the project. Numerous mechanic's liens were filed, the new owner filed bankruptcy, and litigation began in Kansas state court to sort everything out.

In *In re Corbin Park, L.P.*, No. 10-20014 (D. Kan. B.R. December 16, 2010), the U.S. Bankruptcy Court settled the issue of priority between the mechanic's lien claimants and the mortgagee with respect to the Corbin Park property. During the bankruptcy proceedings, both the subcontractor lien claimants and the lender claimed their interest in the property was superior to the others and should be paid first. The lender had recorded its mortgage and then sent written notices to proceed with construction under the new contracts. The subcontractor lien claimants argued that because they had performed work on the project--for the former owner--before the new mortgage was recorded, their mechanic's liens should have priority over the mortgage.

The Court disagreed, holding that "where labor or materials are furnished under successive contracts, the

prior completed contract cannot be tacked to a subsequent contract so as to enlarge the time for filing a lien." Such liens must be filed within the statutory period with respect to each contract and the work done under each contract. A lien claimant cannot name the subsequent purchaser as the owner for work contracted for by the prior owner under a separate contract, and cannot enlarge its time to file a lien by piggybacking onto its contract with the prior owner.

The Court considered that the claimants had actual knowledge of the first priority secured financing, entered into separate contracts with the former and new owners, and received Notice to Proceed letters from the new owner after the mortgage was filed. Furthermore, the ownership change and new contracts did not constitute a mere continuation of the original contracts and the changes were not inconsequential—providing for different prices and different terms. Accordingly, the Court found that the subcontractors could not relate back their mechanic's lien claims ahead of the new lender's mortgage based on their prior work and contract with the original owner. The lender's mortgage was found to have first priority.

Meanwhile, in the District Court case, *Faith Technologies v. Fidelity & Deposit Company of Maryland*, No. 10-2375-MLB (D. Kan. Jan. 26, 2011), several unpaid subcontractors sought to recover the amounts they were owed for their work on the Corbin Park project; both from the contractor and from the surety company that issued payment bonds on behalf of the contractor.

Both the contractor and the surety claimed they were not responsible for paying the subcontractors because the subcontracts contained "pay-if-paid" clauses that conditioned payment from the contractor to the subcontractors on the contractor's receipt of payment from the owner. As the owner had not paid the contractor, the contractor claimed it was not liable to pay the subcontractors. And the surety argued that it was entitled to raise all defenses of the contractor.

In analyzing the arguments, the Court distinguished between a "pay-when-paid" clause and a "pay-if-paid"

clause. “Pay-when-paid” clauses, such as: “Contractor shall pay subcontractor within seven days of contractor’s receipt of payment from the owner,” are interpreted as timing mechanisms that suspend payment for a reasonable period of time. A “pay-when-paid” clause does not create a condition precedent to the contractor’s obligation to *ever* make payment, and it does not shift the risk of the owner’s non-payment to the subcontractor.

However, “pay-if-paid” clauses, for example: “Contractor’s receipt of payment from the owner is a condition precedent to contractor’s obligation to make payment to the subcontractor; the subcontractor expressly assumes the risk of the owner’s nonpayment and the subcontract price includes this risk,” make payment by the owner to the contractor a pre-condition to payment by the contractor to the subcontractors. Although some states have prohibited such provisions by statute, Kansas has not. As such, the Court concluded that “pay-if-paid” clauses are valid and enforceable in Kansas.

The Corbin Park subcontracts provided that “[p]ayment by Owner...to the Contractor shall be a condition precedent to the obligation of the Contractor to pay Subcontractor for any work, claim or damage.” The Court determined that the “pay-if-paid” clause was clear and enforceable, and created a valid condition precedent to payment. As the contractor had not received payment from the owner, it was not liable to pay the subcontractors.

The Court likewise concluded that the surety was liable only to the extent that the principal on the bond—the contractor—was liable. The “pay-if-paid” clause prevented the contractor from being liable to the subcontractors; therefore the clause likewise precluded any claim for payment by the subcontractors against the surety.

Slightly different facts could have yielded a different result. Specifically, the Kansas Fairness in Private Construction Contract Act, K.S.A. 16-1801, *et seq.*, provides that “pay-if-paid” clauses are not a defense to a claim to enforce a mechanic’s lien, claims under public works bonds or to releases of lien bonds pursuant to article 11 of chapter 60 of the Kansas Statutes. K.S.A. 16-1803(c). The bond at issue in this case was a private bond, and therefore not governed by the Act.

For subcontractors, there are important points to be taken from the Corbin Park litigation. First, it is important to know whether conditional payment language in subcontracts constitutes a timing mechanism for payment in the form of a “pay-when-paid” clause; or whether the language shifts the risk of non-payment to

the subcontractor, conditioning payment from the contractor on payment from the owner in the form of a “pay-if-paid” clause. Second, it is important to understand the rules of mechanic’s lien priority and know how to protect those rights. The attorneys at Brown & Ruprecht, PC can help your business assess the risks and protect your interests with respect to construction jobs.

Finally, despite the grim outcomes for many involved in the Corbin Park project, not everyone’s fate was left in the hands of the Courts. Brown & Ruprecht, PC represented several subcontractors and a supplier whom had favorable results.

For more information, please call:

Brown & Ruprecht, PC
911 Main Street, Suite 2300
Kansas City, Missouri 64105
Phone: (816) 292-7000
Fax: (816) 292-7050
www.brlawkc.com

April, 2011