

New tool for Illinois property owners and lenders to remove mechanics liens

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Introduction

The Illinois Mechanics Lien Act has long served as a powerful collection mechanism for Illinois contractors and material suppliers that provide labour or materials for the construction of improvements to real property. (1) The act permits them not only to record mechanics liens against the real property where the work is performed, but also – unlike the legislation in many other states – to claim priority over a previously recorded mortgage up to the value of the improvements to the property. Illinois law also did not permit mechanics liens to be bonded over. Thus, disputed mechanics lien claims, which can take years to resolve through the courts, cast a long shadow on title and frequently stopped efforts to refinance, sell or foreclose in their tracks.

A recent amendment to the Illinois Mechanics Lien Act that permits owners, lenders and other lien claimants to substitute a bond in lieu of the real property itself came into effect on January 1 2016. The amendment will likely represent a sea change in the way disputed mechanics lien claims are handled in Illinois. If a property owner or lender has the wherewithal to post a bond, mechanics lienors asserting disputed lien claims can no longer tie up properties for years while their claims are litigated. Property owners can sell or refinance their properties without first paying in full a mechanics lien claim that they intend to dispute.

Requirements of Section 38.1

The new amendment, Section 38.1, permits an applicant to file with the court a petition to substitute a bond for the property that is the subject of a mechanics lien claim. An applicant may file a petition any time prior to five months after the filing of a complaint or counterclaim by a mechanics lien claimant to enforce its mechanics lien claim. (2) An 'applicant' may be an owner of real property, another lien claimant (eg, a mortgage holder) or a third party that holds an interest in the property (eg, a condominium association or homeowners association).

An applicant should file with the clerk of the court an eligible surety bond, which must satisfy a series of straightforward requirements – the most critical of which are as follows:

- The bond must be equal to 175% of the claimed lien amount;
- The principal and surety must submit to the jurisdiction of the county where the property is located; and
- The surety must have a financial strength rating of 'A' and meet certain other requirements.

Once the surety bond has been obtained, applicants must file a brief petition with the clerk of the circuit court in which the property is located. The applicant must deliver written notice of the petition to the lien claimant. The lien claimant is then permitted 30 days from service of the notice to file objections to the surety bond.

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If no objections are filed in this 30-day window, the applicant may proceed *ex parte* to establish that the surety bond is eligible. If the court agrees, it will enter an order "substituting the security of the bond for the property securing the lien claim and discharging the property described in the petition as being subject to the lien claim".⁽³⁾ If objections are filed, a hearing is set to determine the eligibility of the surety bond. Unlike many other states, where an applicant can simply file the surety bond with the county to accomplish substitution of the bond for the property, Illinois has built in an objection period, which could delay obtaining clear title to the property and any related sale or refinance.

Once a surety bond has been approved by the court, the lien claimant's action to recover on the bond can be asserted against only the principal and surety. No other parties are necessary to the litigation. Importantly, the principal and surety become jointly and severally liable to the lien claimant, but are entitled to raise defences, which are limited to those that could have been brought against the lien claimant as if no surety bond were issued.

Attorneys' fees awarded to prevailing party

Section 38.1 provides for a mandatory award of attorneys' fees to the "prevailing party" in the bond litigation, an award that might not otherwise be available in mechanics lien litigation.⁽⁴⁾ A lien claimant is deemed the prevailing party if the judgment amount is equal to at least 75% of the amount of the lien claim; the award is capped at the amount remaining on the bond after judgment. The principal is deemed the prevailing party if the judgment amount is equal to or less than 25% of the amount of the lien claim; the cap is 50% of the lien claim amount.

Accordingly, applicants should evaluate the extent to which they believe the lien claim is overstated when considering whether to proceed under Section 38.1. An unsuccessful challenge could result in the payment of not only the lien claim and interest, but also attorneys' fees.

Comment

The newfound ability to bond over liens in Illinois is a powerful new tool for property owners and lenders that are looking to sell or refinance a property that is subject to a disputed mechanics lien claim. However, it is not a panacea and comes with significant cost. The 175% bond requirement and concerns over accruing interest and prevailing party attorneys' fee provisions will likely make applicants consider alternatives, including settlement of the disputed lien claim, before turning to this new mechanism.

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Endnotes

(1) 770 ILCS 60/0.01 *et seq.*

(2) 770 ILCS 60/38.1(c).

(3) 770 ILCS 38.1(e)(1).

(4) 770 ILCS 38.1(i).