

**Sabo & Zahn**  
233 S. Wacker Dr.  
Suite 8620  
Chicago, IL 60606  
312-655-8620  
312-655-8622 fax  
[Http://www.sabozahn.com](http://www.sabozahn.com)

# Sabo & Zahn

Attorneys at Law

## Who is the Owner and will you get paid?

**S**enario one: You are a contractor constructing a building for the “Owner,” XYZ Enterprises, Inc. Your payments from the owner are being received later and later. You have trouble meeting payroll and paying the subcontractors. You threaten the owner that you will walk off the job unless prompt payments are made. The owner fires you. How do you get paid? While the mechanics lien laws of the several states may help you, various technical problems may prevent you from enforcing a mechanics lien. An alternative remedy is to arbitrate or sue the Owner for breach of contract. However, you now discover that the only assets of this particular corporation are a telephone, a desk and an old filing cabinet. The property itself is owned by another entity with which you do not have a contract, and the lender is not going to give you any help. Even if you obtain a judgment against the corporation, it will be impossible to collect on that judgment.

Scenario two: You are an architect hired by a “developer,” Ma & Pa, Inc. You sign a carefully negotiated AIA Document B141 with this “Owner.” Six months into the design of the project, with no payments forthcoming (“the check is in the mail . . .”), you learn that this developer/Owner does not really own the property at all. It turns out that Ma & Pa, Inc., was hoping to convince a bank to loan it the money to purchase the property once all of the design drawings were finished. Because that did not happen, Ma & Pa decide to walk away, leaving you holding the bag. What can you do? Unfortunately, your options are limited. You might consider filing a mechanics lien, but because your client doesn’t own the property, this may not be of any use. The only other recourse, as in the contractor example above, is to file a breach of contract action in court or in arbitration. Once again, the problem is that the developer has no assets. Any judgment you get will likely be worthless.

You attorney might pursue some additional remedies in these two scenarios. One is a process known as “piercing the corporate veil.” This can be used to go after the personal assets of the individual corporate owners. You normally have to prove that the corporate

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formalities were disregarded, i.e., the corporate and personal bank accounts were intermingled, or the assets of the corporation were directly used by the owners. If the developer did a reasonably good job in running the corporation as an independent entity, this remedy will probably not work. Other obscure legal doctrines might also be tried by your attorney, but you cannot count on these meeting with success either.

The lesson here is that you need to investigate the status of your client. Whether you are the architect or the contractor, you need to know at least the following:

(1) Who is the client? That is, is this an individual, a partnership, corporation, LLC, or other type of entity. Is the entity required by law to be authorized to do business in that location? If so, is it properly authorized? Who are the officers, directors and owners?

(2) Who is legally obligated to pay your invoices? This can be an issue if the contract is signed by an agent for the owner. Make sure the agent has actual authority to bind the owner. If the contract is with a governmental entity,<sup>1</sup> that entity may not be obligated to pay your invoices unless and until the proper resolution is formally passed by the appropriate board.<sup>2</sup> In some states, land trusts hold legal title to real estate, with the owner as beneficiary of the land trust set up for that purpose. The trustee, usually a bank, signs the contract on behalf of the trust. The trustee will always add a provision to the contract specifying that the trustee will not be responsible for payment of anything. Thus, you cannot sue the party executing the contract.

(3) Does the client have any assets? If there are no assets or they are very limited, is there another source of funds, such as a bank loan from which you might be paid? The contractor has more protection than the architect in this situation, as addressed in A201:

**2.2.1** The Owner shall, at the written request of the Contractor, prior to commencement of the Work and thereafter, furnish to the Contractor reasonable evidence that financial arrangements have been made to fulfill the Owner's obligations under the Contract. Furnishing of such evidence shall be a condition precedent to commencement or continuation of the Work. After such evidence has been furnished, the Owner shall not materially vary such financial arrangements without prior notice to the Contractor.

The architect will want to make sure that payments are promptly made by the client. Paragraph 1.5.7 of B141 requires an initial payment by the client to the architect. This is then credited to the final payment. The architect is also protected by ¶ 1.3.8.1 of B141,

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which allows the architect to terminate or suspend services upon notice to the client if payments are not timely made. Too many architects make the mistake of allowing receivables to pile up for months while continuing work on the project.

(4) Is the client's budget expectation realistic? If you are the architect and a client comes to you to design a building that should cost \$1 million, but the client thinks it can be built for half that amount, you will have a problem. Use of the new AIA Document B141-1997 that requires a discussion about the Project budget (§ 1.1.2.5.1) as well as the Cost of the Work (§ 1.1.2.5.2) can avoid this problem. This factor should not be a concern for the contractor unless the contract documents are inadequate and it is likely that there will be substantial extras as a result. Even if there is a bank loan in place, it will be limited to the amount originally authorized by the bank and extras will probably have to be funded by the owner.

(5) Do not agree to an assignment that might prevent you from collecting fees. This might occur when the contract is contingently assigned to the owner's lender. Lenders typically want you to waive any amount owed prior to the time they take over the project. At the point that a lender takes over, you will likely be owed a very substantial amount of money. A201, § 13.2.2 allows a contingent assignment to a lender only if the lender agrees to assume the owner's rights and obligations under the contract documents. B141 has a similar provision at § 1.3.7.9. These provisions should rarely, if ever, be waived.

Before entering into a contract, you should do a thorough investigation of the client's ability to pay. You should also take care to ensure that, in the event payment is not forthcoming, remedies are readily available. A little homework up front might save a lot of headaches later in the project. Do not get behind in billing or collecting receivables. It is much easier to collect all that you are owed if you do it when the client still needs your services. Sometimes the best decision you can make is to decline a project if you are uncomfortable with the owner.

Werner Sabo, FAIA, CSI  
James K. Zahn, FAIA, CSI

1. These include towns, cities, villages, park districts, school districts, states, counties, and other "public" bodies. Note that lien laws will probably be different when such an entity is your client, and this might also affect your ability to recover.
2. In *McKee v. City of Cohoes Bd. Of Educ.*, 473 N.Y.S.2d 269 (1984), the architect was unable to collect his fee from the school board. The school superintendent had executed the contract, but not in strict conformance with statute. The contract was thus void.

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