

THE SUBSTITUTION OF BONDS FOR CONSTRUCTION LIENS

In the last few articles of this publication the lien law has been discussed, including proposed amendments to improve the protection accorded subcontractors. A 2005 decision of the Wisconsin Court of Appeals will remind the reader that construction liens constitute security in the improved real estate and that the Wisconsin Statutes allow the owner to free the improved property from the lien security by obtaining a bond.

In Hunzinger Construction Company v. SCS of Wisconsin, Inc. (subcontractor) and Demco Wisconsin 4, LLC, (owner) et al., the sole issue before the court was whether the owner was entitled to dismissal from a lien foreclosure action initiated by the subcontractor against the prime contractor. Because the lien security in the property had been released by a bond, the court held that no personal judgment could be rendered against the owner.

In the case, the owner had hired a general contractor to do extensive remodeling work on a building. The general contractor subcontracted with the subcontractor to do demolition work at the site. A dispute arose between the general contractor and the subcontractor regarding payment for the work performed. The subcontractor filed a construction lien claim. The general contractor filed a bond for 125% of the claim of the subcontractor. The bond provided that if the general contractor shall pay all judgments against it then the bond was void.

The general contractor commenced a lawsuit claiming it was entitled to some offsets in the contractual relationship between the general contractor and the subcontractor. The subcontractor filed a counterclaim to collect unpaid compensation and also commenced a third-party action against the owner to foreclose the subcontractor's construction lien claim. While the subcontractor admitted that the prime contractor had filed the bond, it maintained that the owner was still liable to it for its unpaid compensation due from the general contractor.

The Court of Appeals held that the purpose of the bond was to release the owner's

property from the construction lien and that the property owner thereafter had no personal obligation to the unpaid subcontractor. The Court held:

Because the effect of the release bond procedure is to free the real property from the effect of the claim and lien and any action brought to foreclose such a lien and because a lien foreclosure action is an in rem proceeding, unless personal judgment can otherwise be rendered against the property owner, the owner of the lien property is entitled to a judgment of dismissal from the foreclosure action. The action may then proceed against other defendants against whom a personal judgment might be rendered, such as the general contractor, the bond principals and the sureties.

Since electrical contractors are often subcontractors to a general contractor, it is reasonable for the electrical contractor to foresee that any contract provision in the contract between the general contractor and the owner permitting the substitution of a bond for a construction lien claim may result in a bond being ultimately filed which then releases the owner's improved land from the electrical subcontractor's construction lien. Upon the filing of the bond the lien attaches to the bond. The owner has no further liability except for possible nonpayment to the general contractor. The electrical subcontractor must then continue to press its claim against the nonpaying general contractor and the surety. Unless the surety fails financially, adequate security for the unpaid electrical contractor should exist.