

Lake County Contractors Association

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Effective Use Of The Subcontractor's Sworn Statement

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The subcontractor's sworn statement is probably the most effective tool contractors use to insure that lower tier subcontractors and suppliers receive adequate payment throughout the job. Yet many contractors either fail to appreciate how the sworn statement works or simply fail to utilize it, thereby increasing their risk of mechanics' liens, bond claims and potential double payment.

The risk of unpaid lower tier subcontractors and suppliers generally falls on the solvent general contractor for three reasons.

- ✓ First, the general contractor promises, in most general contract agreements, to provide a lien-free job and may even indemnify the owner against mechanics' liens.
- ✓ Second, most mechanics' lien statutes provide little protection to a general contractor who has paid a subcontractor in full before receiving an unknown supplier's timely notice of lien. If the owner is retaining funds on the general contract when the owner receives notice of the lien, the lien claimant is usually entitled to prevail.
- ✓ Third, on bonded projects, the general contractor's guaranty to the bonding company indirectly places the risk of unpaid subtier contractors and suppliers on the general contractor via the payment bond.

The subcontractor's sworn statement provides information from which the general contractor can estimate whether all of the lower tier subcontractors and suppliers have been identified and from whom the general contractor should demand waivers of lien. Included on many of the commonly used waiver of lien forms, the subcontractor's sworn statement should identify all subtier contractors and material suppliers with whom the subcontractor has dealt, the amounts of their contracts, the amounts paid to each to date and the amounts to become due to each. Subcontractors are obligated to provide such sworn statements by statute in Illinois (770 ILCS Section 60/22) and in several other states, and usually by contract as data substantiating the Schedule of Values (AIA A401 paragraph 11.5, 12.2; AGC/ASA/ASL Standard Form paragraph 14.2.1).

Materials constitute between 50 and 60 percent of the subcontract price for many trades. A completed subcontractor's sworn statement permits the general contractor to estimate whether the subcontractor has listed suppliers comprising better than one-half of the subcontract price and whether the subcontractor has paid its suppliers and subtrades in roughly the same percentage as the subcontractor has received payment from the general contractor. If the percentages are askew, the general contractor should ask questions and withhold payment until it receives satisfactory answers. For example, a sworn statement on a \$100,000.00 electrical subcontract might look like this:

Names	What For	Contract Price	Amount paid	This Payment	Balance Due
XYZ Switch	Switch gear	\$20,000	\$10,000	\$5,000	\$5,000
AVC Supply Company	Material and Fixtures	\$40,000	\$15,000	\$10,000	\$15,000

This subcontractor intends to purchase \$60,000.00 in materials for a \$100,000.00 subcontract. So chances are good that, absent fraud, the subcontractor had identified all of its major suppliers. If the subcontractor has received \$40,000.00 to date, it has passed 60 percent (\$25,000.00) to its suppliers. If the subcontractor is seeking payment of \$20,000.00 in this application and is intending to pay \$15,000.00 to suppliers, this subcontractor is passing on more than 60 percent. The subcontractor will have \$40,000.00 remaining in the subcontract after this payment, 50 percent (\$20,000.00) of which will be available to pay suppliers. Assuming that the general contractor is withholding a 10 percent retention, this subcontractor should be able to pay its obligations to suppliers well in advance of the retention release.

If the percentages do not work out because, for example, the subcontract price is 200,000.00 instead of \$100,000.00, the general contractor knows that suppliers or subtrades have been omitted and must ask pointed questions of the subcontractor before releasing funds.

Once the general contractor is satisfied that all suppliers and lower tier subcontractors have been listed and that the subcontract appears to be in balance, the general contractor next insures that the subcontractor is paying its subtrades and suppliers by requiring partial lien waivers from each identified supplier and subtier contractor in the amount listed. If the supplier and subtier contractor waivers do not match the amounts set forth in the subcontractor's sworn statement, the general contractor should withhold payment until the numbers are harmonized. Thus, the system contains an internal check and balance.

For this tool to be effective, the general contractor must insist that the subcontractor's sworn statements be filled out completely and corresponding waivers of lien be obtained before releasing payment. Subcontractors often try to avoid the detailed disclosure by submitting a statement that "All Material Was Taken From Fully Paid Stock And Delivered In Our Trucks." This type of disclosure provides no help to the general contractor trying to manage its mechanics' lien and bond exposure risks. Indeed, Illinois courts have consistently held, since at least 1962, that reliance on such a sworn statement is unreasonable and offers no defense to an undisclosed supplier's mechanics' lien. While some trades do stock materials, virtually no subcontractors stock all materials used on a job; therefore, a statement that "All Material Was Taken From Fully Paid Stock" is most likely false.

The subcontractor's sworn statement is a common document which is part of many common waiver of lien forms. It is the general contractor's most significant tool in managing the risk of mechanics' lien and bond claim exposure to subtrades and suppliers. Absent receipt of the detailed information requested in the subcontractor's sworn statement, the general contractor cannot determine that suppliers and lower tier subcontractors have been adequately identified and that payments are flowing down the contract chain to those potential mechanics' lien and bond claimants.