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WFJ Employees Give for the Holidays

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The employees of WFJ's Minnesota office held a month long holiday food drive from November 8th through December 8, 2006 to raise money and collect items of food for the less fortunate in the community. All donations were given to Second Harvest Heartland, Minnesota's largest hunger-relief organization, which services a 59 county area. The mission of Second Harvest Heartland is "to end hunger through community partnerships." The attorneys and staff at WFJ were pleased to be a part of that mission and hope that the donations from WFJ helped make a difference in the lives of others. For more information visit www.2harvest.org

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Wisconsin has a new law dealing with alleged construction defects and steps a consumer must take in order to resolve those issues. Effective October 1, 2006, consumers must notify contractors and give them an opportunity to resolve any alleged defects prior to the consumer commencing a lawsuit.

The new law significantly alters the landscape of consumer/contractor relations, and there are a number of steps each party must take to protect themselves under this law. The timetable each party must follow is outlined in a brochure supplied by the Wisconsin Department of Commerce. The contractor must provide a copy of this brochure to the consumer prior to any work on the property.

Consumers who have a dispute concerning defective workman-

ship or materials must give written notice to contractors, subcontractors or material suppliers before any legal action may be filed. This includes filing a legal action in court or requesting arbitration.

The new law sets up a five step process for resolving the claim between the consumer and the Contractor. First, at least 90 days prior to commencing a lawsuit or requesting arbitration, the consumer must provide written notice of the defect to the Contractor. The Contractor then has 15 working days to provide the consumer with a written answer. (The Contractor has 25 working days to respond if the claim involves a window or door supplier.)

Upon receiving notice of the claim, the Contractor has several options. The Contractor

may (A) repair the defect; (B) offer a monetary amount to settle the claim; (C) offer a combination of A and B; (D) reject the claim and provide reasons for rejecting the claim; or (E) request to inspect or test the alleged defect.

The third step requires the consumer to respond to the Contractor, or if the claim is rejected, proceed with an action against the Contractor. If the consumer rejects the Contractor's offer, the fourth step allows the Contractor five working days to provide a supplemental offer. Finally, if the consumer does receive a supplemental offer from the Contractor, the consumer has 15 working days to respond.

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Contractors do have a right under this law to inspect and test any alleged defects, and the consumer must provide reasonable access for the inspection, test or repair. The new law applies to a “dwelling”, defined as any premise or

portion of a premise that is used as a home or place of residence.

The new law, and a copy of the brochure that must be supplied to consumers, is available at the Wisconsin Department

of Commerce web site: <http://commerce.wi.gov/SBdocs/SB-UdcRightCureBrochureV4.pdf>.

DISTRESSED PROJECTS: PRIORITY OF MECHANIC'S LIEN CLAIMS RELATIVE TO THE CONSTRUCTION MORTGAGE

Subcontractors and suppliers in the construction industry should already be familiar with the security available to them under the mechanic's lien laws of the states in which they do business. Although the applicability of lien laws and the requirements for enforcing a lien vary from state to state depending on the type of project, virtually every state recognizes situations in which subcontractors and suppliers can claim a lien against the real estate improved by their labor or material. Although enforcement of mechanic's lien rights is an important mechanism that subcontractors and suppliers can use to secure payment of their claims, even mechanic's lien rights may have little or no value if a project ends up in foreclosure and the proceeds of a sale are insufficient to pay all claims in full. In this worst case scenario, who gets paid and how much usually depends on the relative priority of claims.

Projects of any size often require the project owner to obtain a construction loan to finance progress payments to the various contractors furnishing labor and material for the project. Construction lenders typically insist on having first priority as a condition of making the loan. To be sure, the construction lender wants to have priority over all mechanic's lien claims, which taken as a whole can be very substantial.

In Minnesota and many other states, the relative priority of a construction mortgage over other liens (except mechanics liens) is determined by the chronological order in which the mortgage and liens are filed at the courthouse. In a very real sense, it is a “race to the courthouse” to establish the priority of the mortgage over certain other types of encumbrances.

In Minnesota and most other states, mechanic's lien claims present an exception to the general rule of priority based on the date of recording. In Minnesota, for example, the priority of all mechanic's lien claims is determined by the date of “first visible improvement” to the real estate. The date an individ-

ual mechanic's lien is recorded is irrelevant for determining its priority relative to a construction mortgage and even other mechanic's lien claims. All of the mechanic's lien claimants are “coordinate” and have equal rank in priority established by the date of first visible improvement.

In order to ensure that its mortgage has priority over the mechanic's lien claimants, the construction lender will usually inspect the real estate before finalizing the mortgage transaction, in order to ensure that there has been no visible improvement to the real estate. The construction lender will have someone prepare an “affidavit of no visible improvement” in which the person attests to the fact that he or she inspected the property on a certain date and at that time, there was no visible improvement to the property. As long as the construction lender can show that its mortgage was recorded before any visible improvement of the real estate, the construction lender can establish priority over all claims that follow, including mechanic's lien claims.

Mechanic's lien claims often have second priority and follow behind the construction mortgage, although it's possible that a second mortgage or other encumbrance could be recorded at the courthouse before the date of first visible improvement at the project. If so, the mechanic's lien claims may be pushed further down the food chain in terms of priority.

When a distressed project goes into foreclosure, the party with first priority may be the only claimant that receives full payment from the proceeds of a foreclosure sale. If the mechanic's lien claimants are entitled to a share of the excess sale proceeds, they share the proceeds on a pro rata basis. The excess sale proceeds are sometimes insufficient to pay all the mechanic's lien claims in full. For this reason, a mechanic's lien claimant may consider releasing its lien

rights for something less than full payment since it may know that it won't collect more through the foreclosure process.

What happens if there is a delay between the date the construction mortgage is signed and the date the construction mortgage is recorded? The answer can be “nothing” or “everything,” at least when it comes to determining priority of the mechanic's lien claims relative to the construction mortgage. As long as the mortgage is eventually recorded before the date of first visible improvement to the real estate, the construction mortgage will still have priority over all mechanic's lien claims. In this situation, the delay has no impact on the relative priority of the construction mortgage and mechanic's lien claims. However, if the contractor or his subcontractors start work on the project before the construction mortgage is recorded at the courthouse, then all mechanic's lien claimants take priority over the construction mortgage, even future lien claimants who have yet to start work on the project. This flip-flop of the normal priority scheme gives the mechanic's lien claimants much more leverage than they typically enjoy in a foreclosure scenario.

In conclusion, when distressed projects end up in foreclosure, mechanic's lien claimants are often faced with the prospect of taking a discount on their claims and only the construction lender expects to get paid in full. However, this is not always the case. Before taking a discount, a mechanic's lien claimant should carefully review not only the timeliness and validity of its own lien, but also the priority of its lien relative to the construction mortgage. If the construction lender delayed in getting its mortgage recorded, all mechanic's lien claimants may have priority over the construction mortgage and a much higher likelihood of receiving payment in full.

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COLLECTION OVERVIEW: AN ATTORNEY'S PERSPECTIVE

In a previous article, we addressed the importance of a careful and thorough credit application process. However, even a thorough application process does not guarantee timely payments. You may still be faced with a customer who is slow to pay or has accumulated a significant debt that is "outside terms," or past due.

Part II: Pre-Suit Collection Tools

There are collection tools that can be used by a credit manager on past due accounts before filing a lawsuit in order to reduce write-offs and assist with the legal enforcement of claims. Some of these tools include guaranties, promissory notes, and confessions of judgment.

Guaranties:

From an attorney's perspective, a personal guaranty can be a helpful tool in assisting with the collection of a claim. It is often advisable to use a built-in personal guaranty combined with the credit application. However, if your credit application does not include a built-in personal guaranty, a guaranty may still be used with a customer who has accumulated significant past due debt.

A personal guaranty can apply to both present balances and future advances. With a guaranty, your company may require an owner or other interested party to personally guaranty a past due amount as a contingency to any future advances. By having a personal guaranty from an owner, the owner now has an incentive to make sure that the debtor company pays your company before the debtor pays other debts for which the owner is not personally liable. The owner who is personally liable for corporate debts is motivated by self-interest and understandably wants to reduce his own personal exposure if there is any possibility that the company will be unable to pay a corporate debt.

Guaranties can come in both simple as well as sophisticated forms. Whether the form of the personal guaranty is simple or sophisticated, it is important to spell out exactly what the guarantor is required to do. In addition, a guaranty should include terms for payment of interest, collection costs and reasonable attorney's fees.

In the case of a guaranty for future advances, express termination provisions are important. The guaranty must expressly set out the

method by which your customer may provide notice of revocation of the continuing guaranty. These provisions should also ensure that the revocation is ineffective as to any then existing indebtedness of your customer.

Use of carefully drafted guaranties will maximize your customer's incentive to pay you on time, help identify all parties liable for a debt in the event of non-payment, avoid legal disputes as to whether you are entitled to collect interest or attorney's fees, and simplify your attorney's ability to obtain and enforce a judgment.

Promissory Notes:

A promissory note is an agreement to pay a specific amount. If a customer has incurred past due indebtedness, a promissory note can be used to assist the attorney in their collection efforts.

Typically, a promissory note is an agreement to pay a specific amount in installments by a given date with interest. The note should contain provisions for default when the customer fails to make its installment payments. A typical provision for default of a promissory note is to accelerate on notice with interest. This means that the entire amount with interest becomes immediately due upon notice of default. The provisions for default should also include the ability to recover collection costs and reasonable attorney's fees. Promissory notes can also be effectively combined with a guaranty. Always take care in reviewing the capacity in which the promissory note has been signed, either individually or corporately.

There are advantages to using a promissory note to assist in the legal enforceability of a claim. Appropriately drafted and executed promissory notes are clear acknowledgements of a debt. In addition, signatures are presumed to be genuine unless there is very persuasive evidence of a legitimate defense. This means that production of the note entitles the holder of the note to judgment at trial unless a defense has been established. The burden to establish a defense is on the debtor. Therefore, the existence of a promissory note is a clear advantage should it become necessary to bring suit in order to collect

on a claim.

Carefully drafted promissory notes will simplify your attorney's ability to obtain and enforce a judgment. Always consult with an attorney when considering using promissory notes to ensure that the promissory note you use will have the desired effect.

Confessions of Judgment:

A confession of judgment is a sworn statement authorizing entry of a judgment for a specific amount of money and specifying the basis for the underlying obligation. In Minnesota, confession of judgment is governed by statute. Minn. Stat. §548.22.

Public policy requires that statutes authorizing confessions of judgment must be strictly followed. Therefore, an attorney must take care in the drafting of a confession of judgment. As with promissory notes, important terms contained in the confession of judgment include provisions for interest, acceleration on default, collection costs, and reasonable attorney's fees.

A confession of judgment may be combined with a personal guaranty. While a confession of judgment is similar to a promissory note in effect, it does contain one advantage. Both the promissory note and the confession of judgment can accelerate the debt on notice upon default. However, with a promissory note you will have to bring suit to obtain judgment on the note. With a confession of judgment, an attorney may apply directly to the court for judgment without filing suit.

Conclusion

Guaranties, promissory notes, and confessions of judgment, if used carefully, can greatly assist an attorney in obtaining a judgment against a debtor. The likely effectiveness of these tools is often clear to the debtor resulting in a higher likelihood of payment without the necessity of suit. Therefore, the use of guaranties, promissory notes, and/or confessions of judgment will maximize your customer's incentive to pay you on time, help identify all parties liable for a debt in the event of non-payment, avoid legal disputes as to whether you are entitled to collect interest or attorney's fees, and simplify your attorney's ability to obtain and enforce a judgment.

Common Questions That Arise in Starting up a Business

Those starting a new business face a variety of seemingly complex and important start up questions. We repeat some of the questions and answers here for the benefit of all our business clients.

1. Why should I incorporate my business?

Whether you organize your business as a sole proprietorship or choose to incorporate is a decision that should be carefully weighed before you start your business. If you organize as a sole proprietor you can start quickly and have low upfront costs but you are also personally liable for all contracts, tort and other debts incurred by the business. If instead you arrange for an LLC (limited liability company) and follow a few simple rules with your business practices and formalities you can start a single member LLC just as quickly and protect yourself against business debts and litigation risks.

2. My accountant advised me to obtain an (EIN) taxpayer identification number. Can't I just use my own social security number?

While you "may" be able to use your own SSN in some instances, most tax and legal advisors recommend avoiding this like the plague. Obtaining a federal and state EIN number is relatively

painless and inexpensive. Also, you must have an EIN number assigned to your business if you are going to have employees. And, when you attempt to arrange a business checking account the bank will ask for your EIN number as a prerequisite to setting up your account. Lastly, since you will likely be required to provide your tax id number to other businesses and suppliers from an identity theft standpoint, you should not use your own SSN.

3. Do I need a license or permit before I start my business?

Many businesses do require a license or permit from the state to operate. Day care providers, hair dressers, and contractors are all required to obtain a license or permit. Local governments also often require a license before you open your doors. Lastly, you should check to make sure that the place where you intend to operate the business is zoned for business activity before you sign a lease or operate a business out of your home.

4. Why should I purchase insurance if my business is incorporated?

While it is true that you may avoid personal liability (protect your home, retirement and savings) if

you incorporate and follow some basic rules, that does not mean you should automatically conclude that you do not need insurance. If you have employees, you may be required to have workers compensation, unemployment and disability insurance. It is often also to your advantage to maintain a basic comprehensive liability policy to protect your business against personal injury ("slip and fall" and product liability lawsuits) and other types of liability. Such policies may also provide you with a defense lawyer in the event your business is sued, thus avoiding potentially expensive litigation costs while you continue to operate your business.

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