CHAPTER 9

MECHANIC'S LIEN RIGHTS AND GENERAL PRINCIPLES

This chapter presents a general discussion of important mechanic's liens topics and consequently will help you understand mechanic's liens generally. In the following chapters, we will provide detailed discussions of each state mechanic's lien laws, pointing out differences between this general mechanic's lien discussion and each specific state law.

This is not an attempt at a comprehensive work of jurisprudence. That would be impossible in any event. Mechanic's liens are a state law matter. There are fifty states and their mechanic's lien law does vary, increasingly so over time. The author is certainly no authority on the mechanic's lien law in all fifty states.

On the other hand, the mechanic's lien laws of the various United States generally have a common genesis, particularly in the mid Atlantic region. Maryland actually passed the nation's first mechanic's lien law in 1791 "at the urging of [two Virginians] Thomas Jefferson and James Madison, to facilitate the speedy construction of the new capital city of Washington."[1] In the author's experience, the lien laws of Virginia, West Virginia, North Carolina and South Carolina have more similarities than differences. Ironically, it is now the state of Maryland that is most unique in this region. Maryland's legislature dramatically revised its lien law in the 1970s as the result of a constitutional challenge. Most state legislatures and courts have tinkered with their lien law over the years, with the result that lien law between states varies increasingly as time goes on.

Many mechanic's lien principles are similar or the same in all states. This chapter will consider common rules in most states and pivotal differences you must recognize. Rather than cite a great deal of court case law from many states, we will also focus on the practical business economics of mechanic's liens that will drive a case to litigation and then dictate your ability to resolve a case though settlement.

THE IMPORTANCE OF SECURITY

Why are one-year adjustable mortgage rates 6%, while some credit cards charge 18% interest per annum? Each dollar costs the bank the same amount. How can it be cheaper to lend one dollar than the other? Security is the most important difference. Security increases the bank's chances of *preventing* default and collecting its money within terms. In the event of default, the bank increases its chances of collecting faster and at lower cost.

What if the government required all lending to be at the rate of 10%, whether or not the bank had security? Which banks would make money and which would lose? What would determine profitability? The obvious answer again is security. The banks that could consistently get security for their 10% loans would obtain a windfall and become even more profitable. The banks that could not get security would lose money.

What if the market rate for all lending was 0%? What would determine which lenders were profitable? Guess what! The answer is still security. *The market rate for lending in the construction industry* is 0%. Anyone that pays within 30 days gets this 0% rate. Even if there is a credit application that discusses 18% or 24% per annum, anyone that pays within 60 to 90 days probably gets this 0% rate. If you are a 0% lender, security is critical to your profitability.

When you or your business owner computes the price you need to be profitable, risk factor is one of the components considered. In addition to the cost of materials, labor and overhead, the business owner must consider the risks of default and non-collection. If these risks are lowered or eliminated, the business can sell the same product for less without reducing profitability. They now are better able to compete. The good, paying customers will no longer have to pay for the damage caused by the non-paying customers. This is exactly how credit management policies can be sold to credit customers. If they are willing to provide security, the vendor can sell them products cheaper. The customer can be more competitive.

If the seller can decrease the risks of default and non-collection without lowering prices, they have simply increased profits. This is making more money in less time.

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[1] *Barry Properties v. Fick Bros. Roofing Co*., 277 Md. 15, 17-18, 352 A.2d 222, 224-25 (1976).

Why does security decrease the risk of non-collection? When you purchased your last home or automobile, the bank required you to sign at least two pieces of paper. One was your promissory note. This was your "contract" with the bank in which you agreed to make certain monthly payments. This is your "personal promise to pay." This allows the bank to sue you personally in the event of default.

The other paper you signed was a mortgage, deed of trust or other "security agreement." The security agreement provides the bank rights against the "security property." In the event of default, the bank can foreclose upon the security property, whether it is a house, automobile or other property.

The secured creditor has a "bigger hammer" than the unsecured creditor. The secured creditor can cause more immediate problems for the debtor by taking away the house, equipment, accounts receivables or other security property. The debtor will work harder to stay current. The risk of *default* is lower to the secured creditor.

If the debtor is solvent, security is not as important. The lender will be able to go against the debtor on the "contract." The lender will be able to obtain a personal judgment against the debtor and will then be able to attach all assets owned by the debtor.

If the debtor is insolvent or disappears, security becomes critical. The contract or promise to pay will be worthless if the debtor has no assets or cannot be found. If the lender has security, however, the lender will be able to sell the security property to obtain repayment on some or all of the loan. If there is default, the risk of *non-collection* is lower.

WHAT IS A MECHANIC'S LIEN?

If you supply labor and materials for the construction of improvements on real estate, the law provides security in the real estate, whether the debtor agrees to it or not. The mechanic's lien works basically the same as a mortgage, deed of trust or other security agreement. If the contract debtor is insolvent or goes to Jamaica, the claimant will still be able to enforce this security interest in the real estate to obtain repayment of some or all of the debt.

When a contract debtor defaults, the claimant supplying labor or material can elect to sue the debtor on the promise to pay, to proceed against the property, or elect to do both at the same time. In the event of bankruptcy by the contract debtor, the claimant who proceeds against the property will be a "secured creditor" in bankruptcy and will have rights in the security property. It may even be possible to enforce security rights against the property while the contract debtor is still in bankruptcy and while all "unsecured creditors" are still waiting around to see whether there will be any distribution.

A construction contractor wants to make sure that the company has both a contract (promise to pay) and security rights. Smart contractors make sure they have a strong enforceable contract with a solvent debtor. Smart contractors will also make sure that good security rights exist and then take whatever steps are necessary to preserve those security rights. Preserving both avenues of recovery will dramatically decrease the chance of default and increase the chance of collecting. It is not necessary for the contract debtor to agree to a mechanic's lien, but it is necessary to strictly comply with the procedures for preserving mechanic's lien rights.

All contractors should be thankful to the state legislature for providing this security interest and then be very careful to preserve these rights. Contractors must understand some important differences in mechanic's lien rights from state to state. Will this be a difficult project to enforce mechanic's lien rights? Will this mechanic's lien have a high or low priority? Can they simply file a memorandum of mechanic's lien to preserve rights in the short term, or must they go through an entire court procedure?

Contractors must understand the limitations of security rights. If security rights are weak, it is much more important to determine whether the customer is solvent or has a good track record. Weak security rights mean that the contractor must carefully evaluate the financial strength of the project and customer, carefully negotiate contract terms, consider requirements for alternate security and must watch the project much more carefully. If good and easy mechanic's lien rights exist, the contractor may decide to take a chance on a riskier customer offering strong profit margins.

The contractor must also understand the varying mechanic's lien statutes in different states to make sure that rights are preserved. Mechanic's lien laws in various states are similar in some ways, but many contractors have lost much money assuming the rules are identical. It is important to be aware of the little differences in deadlines and the procedures to preserve mechanic's lien rights.

Mechanic's liens only matter if the debtor is insolvent. If a debtor is solvent and in business, the contract action will accomplish all objectives of the creditor much cheaper and much faster than mechanic's lien litigation. Indeed,

the contract action will accomplish more than mechanic's lien litigation if you have a contract with an attorney's fee provision. This is normally the only way a creditor will ever get attorney's fees in mechanic's lien litigation is if there is a written contract calling for attorney's fees and the debtor remains solvent in order to enforce that provision.

In other words, it will usually be necessary to file a mechanic's lien on default, but you may not want to enforce the lien. The deadline to perfect will come fast. The typical deadline to file a mechanic's lien is 90 days after last work, while the creditor does not know there is a problem until 60 or 70 days after last work. There is no way to go back and get the lien if it later turns out that the debtor is insolvent. The mechanic's lien also provides a great "glorified demand letter" that will often result in payment without filing suit. The mechanic's lien is the remote contractor's legitimate way to circumvent the debtor and draw the owner and/or general contractor into the payment dispute.[2]

On truly small claims of a few thousand dollars, it may not be worth filing a lien, especially if you could accomplish your objectives with a small claims suit for the same cost. It is relevant to ask whether they would ever want to enforce the mechanic's lien, because of the high litigation costs. Even if you make the decision to file the lien because there is no time to make a careful analysis, lawyers and clients should later seriously ask whether they need to or want to enforce the mechanic's lien.

The complaint to enforce the mechanic's lien will be more expensive than a contract complaint, because of multiple parties. The really big costs, however, come in the actual litigation. There is no need to go through this if the debtor is solvent. A claimant usually has several months between the deadline to file the lien and the deadline to enforce. During this period of time it is sometimes a good strategy to file a simple contract action.[3] This may cause the case to settle at a low expense. You may learn in the contract action that there are legitimate performance issues and the claimant may not be able to prove that they are owed the money. You will be glad you did not spend the money to enforce a lien if this happens. On the other hand, if the debtor does not answer the lawsuit and you get a default judgment, you have learned that the debtor is insolvent and your only chance of collecting is through the mechanic's lien.

PROJECT INFORMATION

In every state, correct project information is very important to assess security options, ensure mechanic's lien accuracy, hold costs down and cut the time an attorney will need to prepare a lien claim.

Information is collected on the project early in a proactive credit management strategy. You want to know what security rights you have before you agree to supply labor and materials. If you determine a project is bonded, then your risk factor is lower and you do not need as much documentation from your customer. If there is no bond and mechanic's lien rights are weak or expensive, you must think more about requiring personal guaranties or COD shipments.

Clients want to collect information early in a project to be able to quickly and accurately enforce security rights later, if necessary. It is always easier to collect such information while you are still friends with your customer. Debtors, general contractors and owners are not as likely to cooperate once you have already supplied labor and materials and problems occur. When a customer is more than 60 days past due, they are not likely to return phone calls or provide copies of payment bonds.

Once you have a problem, you will be very short on time. Information is important for the traditional reactive approach of enforcing security rights after a problem has arisen. Collecting information on the project early will ensure mechanic's lien and bond claim accuracy, allowing you to move quickly and to hold your cost down.

The Project Information Sheet in the Appendices will help prompt you on the information needed. A site plan for the project and/or copy of the building permit are the single most important documents to have as the best source of information to identify the project and begin title search. A site plan can be very important to solve allocation problems in multiple parcel or unit projects and to determine the value of labor and materials supplied to each unit or parcel involved.

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[2] Many property owners and their lawyers will often assert that the lien is "slander of title" and must be immediately removed. There certainly can be problems for filing a lien in bad faith. However, a creditor has every right and at least a qualified privilege to pursue its statutory rights. *Donohoe Constr. Co. v. Mt. Vernon Associates*, 235 Va. 531, 537, 369 S.E.2d 857 (1988).

[3] Maryland Real Property Code Section 9-111; Va. Code Anno. §43-23.2 (Michie 1950). Be careful, however, about splitting causes of action or claim preclusions. *See e.g.,* Va. Sup. Ct. Rule 1:6.

Material suppliers and remote subcontractors should be sure they know the names, addresses and telephone numbers of the owner, general contractor, architect and bonding company. You will want to be able to contact both the owner and any general contractor in the event of a problem in order to "freeze payments" and arrange joint checks or direct payment. In order to prepare a bond claim, you will need the general contractor and bonding company information. For a mechanic's lien, you will need the owner and general contractor information, along with a description of each lot or parcel of land involved in the project, and the description of labor and materials supplied to each lot or parcel of land involved in the project.

It is also important to know whether you are a true general contractor. Under most mechanic's lien laws, a general contractor is defined as any contractor with a direct contractual relationship with the owner. This status can be very important since it can determine whether notice is necessary or if a "defense of payment" exists.

Some projects use numerous corporate entities to create "artificial" tiers of general contractors and subcontractors. You may have a contract with the ABC Corporation, but if ABC Office Project, Inc. owns the land, then you are a subcontractor and not a general. Being aware of this difference can be important since a subcontractor must act quickly to file liens in order to avoid a defense of payment. If the contract between the owner and the related general contractor corporation calls for the general contractor to be prepaid for all construction work, then the subcontractors, who thought they were general contractors, may never be able to lien the job under any circumstances. While this result is frightening and perhaps fraudulent, this scheme may work.

Many private construction projects also will have payment bonds. For most public projects, either construction or other types of procurement, you will have payment bond rights. It is very important to be aware of the bond rights that may exist. Payment bond rights are very effective and inexpensive compared with enforcing mechanic's lien rights. The existence of a payment bond will make you much more comfortable about your prospects of getting paid, enabling you to bid the project more aggressively and to forego other types of security.

PRESERVING SECURITY RIGHTS

Contractors must understand the deadlines and procedures for preserving mechanic's lien rights in each market's geographic area. The 50 State Summary Mechanic's Lien Law Chapter and the 50 State Summary Payment Bond Law on Public Projects Chapter, as well as the complete chapters in this book about state law in Virginia, Maryland, Pennsylvania and the District of Columbia, should help.

PREFILING BEFORE CONSTRUCTION

In order to preserve mechanic's lien rights, some states do require the contractor to give notice or file a paper before or soon after supplying materials. These "prenotices" sometimes involve a mailing to the owners or to a "mechanic's lien agent." Sometimes it is necessary to file a document with the court. These prefilings are often simpler than a full mechanic's lien filing. A contractor is often able to send these notices without the help of an attorney. It is obviously important for a contractor to learn about these requirements *before* working in a particular state. (*See* the 50 State Summary Mechanic's Lien Law Chapter.)

LIEN AFTER WORK

A good rule of thumb is that bond and lien claims in most states must be made within 90 days of the last supply of labor or materials. Relying on this in any one state, however, could cost a lot of money. (*See* the 50 State Summary Mechanic's Lien Law Chapter.)

Completion of the Project and Claimant's Last Work

How do contractors know when a project has been completed? Does trivial work, warranty work or repair work extend the deadline for mechanic's lien filing? The general rule is that any *original* contract work required to complete the contract will extend the deadline for filing a mechanic's lien.

Minor work will normally extend a contractor's mechanic's lien rights, if it is a part of the original contract's scope of work. The status of replacement items, repair work or warranty work is less certain. Suppose an electrician went back on a project to screw in one light bulb. If that light bulb was definitely part of the original contract and

had never been there before, then this probably extends lien rights. If the light bulb had been broken or did not work properly, it is questionable whether lien rights can be extended.

Punch lists and other communications from the customer are helpful, at least in this regard. If the contractor is required to complete the punch list item, then the contract is not complete. Lien rights do not begin to run until this punch list item is completed. It would be inconsistent later for the owner to argue that the contract had actually been finished earlier.

If there is more than one contract for the supply of labor or materials, then each contract may run its own deadline. Labor or materials supplied under the second contract may not extend the time to lien for money owed on the first contract. This is important when considering "change orders" or "extra work." It may make a difference what you call this additional work. If work is a change order to the original contract, it will probably extend the time to lien for the original contract. If it is a separate extra work order or a new purchase order, it may not create more time.

If there is more than one parcel of land in the project, each lot or parcel of land or will normally run its own mechanic's lien deadline. It is not sufficient to know whether the customer is late on the invoices generally. You must know whether 90 days have passed since your last delivery of labor or material on any particular piece of real estate.

Deadlines for Open Account Suppliers

When materials are furnished under separate contracts, the right to lien for each contract often dates from the time materials are furnished under each contract. Unless there is a "continuing contract" to furnish materials on the whole project, time limits may run from each separate order.

If there is a written or verbal contract for the entire project, then the deadline will normally count from the last day labor or material is furnished to the project as a whole.

Many open account sales, however, will still be in a gray area. Even without an explicit contract for the whole project, the material supplier will be entitled to count the deadline from the last delivery if there was a "continuing" agreement to furnish materials and the parties "contemplated" that a certain supplier would furnish through the end of the project. It may be important to a supplier to quote an entire project, or at least have information on hand about the entire project, for this purpose.

Tickle Systems

Tickle systems are very important to track aging accounts. Such a system must be linked to the last day labor or materials are supplied and *not* linked to the date of invoice. Most computer programs and accounting procedures run from the last date of invoice. This will not work for companies in the construction or public procurement businesses. These procedures or programs must be modified.

The best practice is to start the rotating tickle system when the major portion of your work ends. It should be the duty of the project or production manager to inform the accounts receivable department when shipment has been made or your construction crew is pulling off the job. This may give you an additional cushion because a punch list may add additional time to your lien rights.

Material suppliers should have a company policy of dating all invoices with the date of delivery, even if the invoice is physically printed another day. Then when a credit manager is looking at an accounts aging summary, they know how much time has passed since the last delivery. Mechanic's lien or bond rights are often lost, because clients are looking at the invoice dates and not the delivery dates.

Labor and material contractors must normally use a different tickle system. They are usually billing monthly and may be on the project doing punch list long after the job has been billed in full. Someone in the company must have the responsibility to recognize when the project is substantially complete and then track the date to make sure lien or bond rights do not expire. It is often helpful and cheap to buy an account system like Quick Books to generate an artificial internal "invoice" when you have substantially completed your work. The credit manager can then track this artificial invoice in a conventional aging summary.

All suppliers and contractors must remember that each project or parcel of land will normally run its own mechanic's lien deadline. It is not sufficient to know whether the customer is late on the invoices generally. You must know whether 90 days have passed since your last delivery of labor or material on any particular piece of real estate. For this purpose, aging summaries should show more than just the customer name and the age of that customer's invoices. The summary should show each project as a separate line item. This is discussed in greater detail in the mechanic's lien portions of this book.

TRACING AND ALLOCATION

In order to have lien rights in most states, you must be able to trace labor or materials and show the type and dollar value of labor or materials used in each piece of real estate. A lien may be invalid if it "overburdens" by claiming more than the materials that actually went into that parcel. An "over-inclusive" lien may also be invalid, because it includes too much property and claims lien rights against property that did not receive labor or materials.

As evidence, delivery tickets for material suppliers are normally sufficient, but they must make sure those tickets show exactly how to allocate the materials between each parcel of land. This is especially difficult in townhouse developments. Both the builder and the supplier plan shipments by "building." If that building has eight townhouse units, however, there are eight different pieces of real estate for allocation purposes. Counter sale or bulk sale suppliers must require this information at the point of sale. Computer programs should not permit a sale until the customer has provided information on the allocation of these materials. It is also possible to do a materials take-off from a set of plans.

Many states have special rules for subdivision and utility improvements that make tracing and allocation easier. Contractors that supply labor or materials for roads, water systems or sewer systems want to be familiar with these lien rights in each market state.

SERVICE OF LIEN NOTICE

In addition to filing a mechanic's lien in the land records, lien claimants must usually provide notice of the mechanic's lien to the owner. For a general contractor lien, the law may assume that the owner is aware that the general contractor has not been paid and no notice to the owner is necessary.

Because the owner is not aware of the status of accounts between the general contractor and its subcontractors, the law normally requires that a subcontractor send notice of the lien so that the owner can protect itself. The notice must usually be sent by certified or registered mail or served by the sheriff.

DEFENSE OF PAYMENT: OWNER'S RESPONSIBILITY FOR PAYMENT TO SUBCONTRACTORS

Money flows down the payment chain from the lender to the owner to the general contractor to the subcontractor to the supplier. One bit of information to collect on default is "who has the money" within this payment chain. If the debtor received the money 90 days ago and is now 60 days past due, the claimant is in serious trouble. If the money is still held by someone up the payment chain and the claimant can contact them, the claimant will normally be in better shape. They may have the practical ability to "jam-up" the money to keep it away from the debtor. Everyone also has an opportunity to solve the problem without "hurting" anyone. This may also be important to preserve security rights.

In some states, the validity of the mechanic's lien will depend on the status of accounts between the debtor and the contractors further upstream. Mechanic's lien statutes in New York, North and South Carolina, West Virginia, the District of Columbia and Virginia, for example, have a "defense of payment" where the owner or general contractor is required to pay for the project only once. If the owner or general contractor can show they have paid for the project in full, they have established a defense to any mechanic's liens filed.[4] This is the "defense of payment." (*See* the 50 State Summary Mechanic's Lien Law Chapter.) This is sometimes referred to as a "derivative lien." The subcontractors' lien rights are "derivative" of the general contractor's lien rights. This is also sometimes referred to as the "New York System."

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[4] Under the Virginia Code, this is an affirmative defense of the owner. Va. Code Anno. §43-7(A) (Michie 1950). The burden of proof can vary in other states, however, with an important practical impact. In Maryland, the only time a property owner has a defense of payment is a person building his own residence on his own land. Such a homeowner is protected if the homeowner pays all contractors with whom the owner had a direct contract. If the owner does raise this issue and presents evidence sufficient to establish that the owner either had paid the prime contractor in full or was indebted for an amount less than the subcontractor's claim at the time the subcontractor's notice was sent, a question of fact exists on which the subcontractor has the ultimate burden of persuasion. Maryland Real Property Code Section 9-104(a)(2); *Winkler Construction Co. v. Jerome, 355 Md. 231, 734 A.2d 212 (1999); Ridge Sheet Metal Co. v. Morrell*, 69 Md. App. 364, 517 A.2d 1133 (1986).

This may create a practical deadline for mechanic's lien filing that is much sooner than 90 days. The contractor must send notice of the mechanic's lien to the owner and upstream contractors before payments "flow downstream" to the debtor. THIS IS THE REAL DEADLINE FOR FILING A MECHANIC'S LIEN for subcontractors and suppliers in states with a defense of payment. It is also important to contractors to make sure they have the names and addresses of all owners and upstream contractors before shipment. Additionally, contractors should then keep track of the status of payments after shipment. Informal notices will often stop owners or general contractors from making further payments. By definition, general contractors (anyone with a contract directly with the owner) do not need to worry about a defense of payment in filing a mechanic's lien. The issue is simply whether the owner owes them any money.

In some states, such as Maryland, there is no "defense of payment" for the project owner. The owner can be required to pay for the project twice. Even if the owner has paid the general contractor in full, a subcontractor will still be able to establish a lien and eventually foreclose on the property. The burden is on the owner to make sure that all subcontractors are paid. The owner receives the ultimate benefit of services and materials and, as a practical matter, controls the cash. This type of mechanic's lien law was designed to make property owners a source of payment for subcontractors, in addition to the general contractor.

It is interesting that different state legislatures have considered this issue and come to polar opposite conclusions. Some states put the burden on the property owner to make sure all contractors are paid. Other states put this burden on contractors to make sure they are doing business with credit worthy customers. This illustrates that we are dealing with a battle between innocents. Different people can come to different conclusions that seem fair and just.

Whether you are in a defense of payment state or not, the most important question in every mechanic's lien or payment bond case is the status of accounts upstream. Is the owner holding sufficient money on the general contractor and/or is the general contractor holding sufficient money on the subcontractor to cover your lien. This is what determines whether you are in true mechanic's lien litigation. If you catch enough money with a formal or informal notice, this is when the telephone rings and somebody wants to make a deal. If the debtor does admit (or does not deny) owing you the money, the owner and general contractor would rather you get the money.

It can be very helpful to be in a "no defense of payment" state and have lien rights, even if the owner has paid in full. However, if the owner has paid in full, this is a battle between innocents. You are trying to make an innocent party pay for your material. You will have a big fight on your hands and have a much harder time collecting.

REMOTE SUBCONTRACTOR AND SUPPLIER LIENS

In some states, contractors and suppliers will have lien rights only if they dealt directly with the owner or general contractor. In other states, anyone who supplied labor or materials to a project has lien rights no matter how remote they are from the property owner. This difference is critical to suppliers, who are usually more remote. The supplier dealing with a subcontractor may have no possibility of mechanic's lien rights and will always be an unsecured creditor. (*See* the 50 State Summary Mechanic's Lien Law Chapter.)

TENANT WORK

Labor and materials are often ordered not by the "fee simple" property owner but by a tenant. Such construction contracts can involve a great deal of money, when the tenant is a restaurant, large department store or large corporate office.

In general terms, a contractor can obtain a lien only on the property of the person ordering the work.[5] An underlying property cannot be subject to a mechanic's lien if the fee simple owner did not order or authorize the work. If it is the tenant ordering the work, the tenant is usually the "owner" for mechanic's lien purposes. The contractor cannot obtain a mechanic's lien in the building and underlying ground but can obtain a mechanic's lien in the "leasehold interest" of the tenant.[6] In theory, the mechanic's lien holder can foreclose upon this leasehold interest and become the owner of the leasehold interest.

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[5] *Cabana, Inc. v. Eastern Air Control, Inc.*, 61 Md. App. 609, 487 A.2d 1209, cert. denied, 302 Md. 680, 490 A.2d 718 (1985), *citing Noone Electric Co. v. Frederick Mall*, 278 Md. 54, 359 A.2d 91 (1976).

[6] Maryland Real Property Code Section 9-103(c)(2); Va. Code Anno. §43-20 (Michie 1950).

Most modern office or shopping center leases state that the tenant will be in default if the tenant fails to pay for labor and materials supplied or if a mechanic's lien is filed. The landlord can declare the tenant in default as soon as a mechanic's lien is filed and then terminate the lease. A contractor may have nothing, if the contractor is left with a mechanic's lien in a lease that has been terminated.[7] A lien on a leasehold is extinguished when the rights of the lessee expire.[8] This makes the contractor more likely to seek a lien on the underlying property.

Much uncertainty exists in determining when the fee simple owner's interest is subject to the mechanic's lien. Usually, "mere knowledge" of the fee simple owner of the construction project is not enough.[9] Some states have held that even if a lease requires the tenant to construct a building, the fee simple owner's interest in the real property will not be subject to the lien when the tenant does construct that building.[10] Other states have held that the owner's "consent" to the work is sufficient to subject the owner's fee interest to a mechanic's lien.[11] At some point the tenant becomes the "agent" of the owner for construction purposes, or the owner is so involved in the construction process that a court would decide that the fee simple owner is authorizing the construction and consciously subjecting the property to mechanic's lien rights.

It varies from state to state what level of involvement by the owner is necessary. In the modern shopping center lease, the tenant is often required to construct improvements. The tenant must submit to the landlord detailed blueprints of the planned improvements for landlord approval. The landlord often physically signs or initials the plans as approved. The owner's participation is often necessary for rezoning applications and building permits. The landlord usually has the right to inspect and reject construction work. This collectively may be enough to subject the property to a mechanic's lien.

It is also possible that a contractor could have a lien in the leasehold *improvements* themselves, even if the contractor does not qualify for a lien in the fee simple owner's interest in the real property. It may be helpful to have the right to foreclose upon the improvements, even if there is no right to foreclose on the real estate. There is also some support in some states for the theory of "merger." When a landlord retakes premises, the leasehold and the fee merge, subjecting the owner's interest to the lien against the tenant's interest.[12]

PRIORITY

Various types of liens can be placed on a piece of real estate. Some liens are placed on the property purposefully by the property owner, such as a mortgage. Other liens are "involuntary" or "judicial," including judgment liens and mechanic's liens.

The general rule is that all liens have priority in the order that they are filed in the land records. The term "first mortgage" or "first trust" means that this was the first in time to be filed in the land records. A "second mortgage" is the second in time to be recorded in the land records on that property. If the property is foreclosed, the first lien holder has a "higher priority" to the proceeds of sale and will receive all of the proceeds of sale until paid in full. If there are any sales proceeds left, they go to the second mortgage holder, until the second mortgage holder is paid in full, and so on. The priority of any type of lien is extremely important and will often determine whether or not the lienholder gets paid. A lien with low priority can easily be worthless.

There are very few exceptions to this "first in time, first in right" general rule. One exception is tax liens. Another exception is a mechanic's lien that is "inchoate" (*in-ko-ate*) as are mechanic's liens in Pennsylvania, Virginia and the District of Columbia (but not Maryland). If a mechanic's lien is inchoate, this means that the lien "relates back" to the time when work began on the property, even if the lien claim is not filed with the court until a later time. The lien exists from the moment labor or material is supplied to the property, as long as the claimant eventually perfects the lien by following the procedures in that state.

In a state without an inchoate lien, such as Maryland, a sale of the property or a bankruptcy may cut off lien rights.

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[7] *Feuchtenberger v. Williamson, Carroll & Saunders*, 137 Va. 578, 120 S.E. 257 (1923).

[8] *Trace Constr., Inc. v. Dana Barros Sports Complex, LLC*, 459 Mass. 346, 357 (Mass. 2011), *citing Annot., Enforceability of Mechanic's Lien Attached to Leasehold Estate Against Landlord's Fee*, 74 A.L.R.3d 330, § 7[a] (1976 & Supp. 2010).

[9] *Trace Constr., Inc. v. Dana Barros Sports Complex, LLC*, 459 Mass. 346 (Mass. 2011); *Feuchtenberger v. Williamson, Carroll & Saunders*, 137 Va. 578, 120 S.E. 257 (1923).

[10] *Atlas Portland Cement Co. v. Main Line Realty Corp.*, 112 Va. 7, 70 S.E. 536 (1911).

[11] *Trace Constr., Inc. v. Dana Barros Sports Complex, LLC*, 459 Mass. 346 (Mass. 2011).

[12] *See e.g., Waite Lumber Co. v. Masid Bros., Inc*., 189 Neb. 10, 14, 200 N.W.2d 119, 122 (1972); *Evans v. Young*, 10 Colo. 316, 323-24, 15 P. 424, 427-28 (1887); *Koenig v. Mueller*, 39 Mo. 165, 169 (1866).

Sale or Foreclosure of Property

A sale or foreclosure of a construction project will not defeat an inchoate mechanic's lien. Any real estate purchaser must be aware that inchoate mechanic's liens might be filed after they purchase the property, if the prior owner fails to pay. Because the lien existed on the property since the time the claimant supplied the labor and materials, the purchaser took the property "subject to" the lien, even though there was no notice of the lien. For this reason, real estate purchasers and title insurance companies always insist that the real estate seller sign an affidavit stating that no labor and materials have been supplied to the property in the last 90 days or that payment has been made for all such labor and materials.

The priorities of various liens on real property also determine whether or not the liens survive foreclosure. If the first mortgage holder forecloses, then the second and third mortgage holders are eliminated. These inferior lien holders have no security interest in the property after foreclosure. All liens that are "inferior" to the foreclosing lien holder are eliminated, but liens that are "prior" will survive the foreclosure. If a second mortgage holder forecloses, the first mortgage holder would be unaffected. The foreclosure purchaser now owns the property "subject to" the prior first mortgage lien.

If a mechanic's lien is "inchoate," it is prior to most other liens. The inchoate lien survives most foreclosures and can often be filed after foreclosure. A lender may foreclose on a property, only to see a mechanic's lien filed afterwards. The mechanic's lien claimant must be certain to name the new property owner in the mechanic's lien, but otherwise lien rights still exist.

The priority of construction loan advances is particularly touchy for mechanic's lien claimants. The construction loan documents may be filed in the land records before any work began on the property, but the bank did not actually advance money until each loan draw after the labor and materials were supplied. Is the mechanic's lien in this case prior or inferior to the loan advance? This seemingly minor issue can easily determine whether a mechanic's lien claimant gets paid. If a project goes belly up part way through construction, someone must spend a lot of money to finish the project. The unfinished project will not be worth what the bank has advanced. Even in states with inchoate liens, the rules vary on the relative priority of mechanic's liens and construction loan advances.

It is very important to understand that mechanic's liens in some states, such as Maryland, are not inchoate at all. The claimant has no mechanic's lien unless and until the Court establishes a lien after a court proceeding. It is as if the claimant walked into the courthouse the day of the court hearing and filed the lien, instead of getting the lien back on the day labor or materials were supplied. This court hearing could be months after labor and materials were supplied. Any new mortgages or judgments during that time will have priority. A sale of the property during this time will defeat lien rights.

Bankruptcy

The "automatic stay" of the United States Bankruptcy Code does not stay the perfection (filing in the land records) of the inchoate mechanic's lien. The lien filing is not a "preference" because the claimant always had the mechanic's lien from the moment labor and materials were supplied. The lien filing just gives public notice of this fact.

This means that if the owner on the project files bankruptcy, a general contractor or subcontractor can still file their mechanic's lien, and they will be secured creditors in the bankruptcy. If a general contractor files bankruptcy, a subcontractor can still file its mechanic's lien.[13] If a general contractor files bankruptcy, a subcontractor can still file its mechanic's lien. In fact, it is important to keep in mind that the mechanic's lien *must* still be filed within the normal time limits.

The bankruptcy of the project owner,[14] the general contractor[15] or any other upstream contractor can delay the time for filing the lawsuit to enforce the mechanic's lien.[16] The automatic stay of the Bankruptcy Code means that any

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[13] *Concrete Structures, Inc. v. Tidewater Crane and Rigging Co.* (*In re Concrete Structures, Inc.*), 261 B.R. 627, 640-41 (E.D.Va. 2001) ["the recording of a memorandum of lien does not violate the stay imposed by §362(a)"]; *H.T. Bowling v. Bain* (*In re Bain*), 64 B.R. 581 (W.D.VA. 1986).; *Schafer v. Carolina Kitchen & Bath, Inc. (In re Orndorff Constr.)*, 394 B.R. 372375-76 (Bankr. M.D.N.C. 2008) [Pursuant to Section 362(b)(3), a bankruptcy petition "does not operate as a stay ... of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under Section 546(b)."]; *See also* 98 A.L.R. 32.

[14] *McCoy v. Chrysler Condo Developers Ltd. Partnership*, 239 Va. 321, 389 S.E.2d 905 (1990).

[15] *In re Richardson Builders,* 123 B.R. 736 (W.D.Va. 1990); *Thompson v. Air Power, Inc.*, 248 Va. 364, 448 S.E.2d 598 (1994).

[16] *In re Concrete Structures, Inc.*, 261 B.R. 627 (2001); *Graybar Electric Company, Inc. v. Property Technologies, Ltd.* (*In re Property Technologies, Ltd.)*, 263 B.R. 750 (Bkcy Ct. E.D.Va. 2001).

mechanic's lien claimant is not permitted to file their Complaint to Enforce a Mechanic's Lien if the owner of the real property, the general contractor, or any upstream contractor has filed for bankruptcy. The mechanic's lien claimant is provided additional time, however, to file later. It is often possible to get "relief from the automatic stay" from the bankruptcy court to file the lawsuit or the lawsuit to enforce the mechanic's lien can (and must) be filed within 30 days after the automatic stay terminates (normally when the bankruptcy has ended or otherwise is dismissed).[17]

In states that do not have an "inchoate" lien, the claimant is an unsecured creditor, until the court establishes a lien. The creditor is not allowed to bring court action to establish the lien, because this would improve the creditor's position. The claimant will remain an unsecured creditor and will have to share with other general unsecured creditors in whatever assets the debtor has left after all secured creditors have been paid. As a practical matter, this usually means the lien claimant will receive nothing.

If a property owner files bankruptcy within 90 days after a non-inchoate lien is established by a court, then the lien may be a preference that can be avoided (set aside) by the bankruptcy court. This is a radical difference between a lien that is inchoate and one that is not. With an inchoate mechanic's lien, a claimant is a secured creditor from the moment labor and materials are supplied to the property. The mechanic's lien claimant will retain secured status even though lien enforcement proceedings are filed long after bankruptcy.

Can a Paid Lien Claimant Be Worse Off than If Unpaid?

The U.S. Fourth Circuit Court of Appeals has held that a bankruptcy preference occurred when a creditor with both mechanic's lien and bond rights received a payment (Transfer) during the preference period. The creditor had shown that it had mechanic's lien rights at the time of the Transfer and that the bankruptcy estate had received value for the Transfer, by showing that the owners and general contractors on the projects were holding funds in amounts greater than the Transfer at the time.

Ironically, an unpaid supplier or subcontractor may be actually better off than a paid supplier or subcontractor in the event of bankruptcy. A sub or supplier that received payment in the 90 days prior to bankruptcy will need to return the payment as a preference, unless they can prove ordinary course of business or some other defense. The paid creditor obviously did not perfect their lien rights, since they were paid. An unpaid creditor, however, could file and enforce their lien even after the bankruptcy petition and may be paid in full.

This is discussed in greater detail in the chapter on Bankruptcy.[18] However, the ramifications of this for construction contractors and suppliers are enormous. First, any construction supplier or subcontractor would need to refuse payment and instead file mechanic's lien or on bonds as an ordinary practice (as soon as the debtor was one day beyond its ordinary terms) to avoid bankruptcy preference claims.

The only safe path would be to actually file mechanic's lien or on bonds in all cases, to be released on receipt of payment. This would disrupt projects and business relations, generate legal fees and consume court resources toward no end. This has obvious problems, but is the only risk free alternative. There will be cases with enough money involved that creditors must proactively take this action.

MECHANIC'S LIEN WAIVERS

All types of waivers must be "clearly and unambiguously expressed." Persons should not be able to accidentally waive legal rights.

This general rule on waivers also applies to waiver of lien rights in most states. A waiver of lien rights must be clear and unambiguous. If there is doubt whether a waiver was intended, then the claimant will likely retain lien rights. In addition to this general rule, some states have created laws that further prevent waiver of mechanic's lien rights.

Some states, such as Maryland, do not allow mechanic's lien waivers in the construction contract. Contract clauses stating that subcontractors "hereby waive all rights to lien" are "void as against public policy."

It is still possible to waive mechanic's lien or bond rights in a document separate from the construction contract. Subcontractors may be required to provide releases in exchange for partial payment. These releases can waive future lien rights for future deliveries. These problems in waivers are discussed in greater detail in the chapter on Contracts and Preserving Rights.

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[17] *McCoy v. Chrysler Condo Developers Ltd. Partnership*, 239 Va. 321, 389 S.E.2d 905 (1990).

[18] *See* chapter, Bankruptcy Primer for Creditors; section, Preferences.

In some states a general contractor can waive a subcontractor's right to a mechanic's lien. If the law allows this, most sophisticated owners and almost all construction lenders will require the general contractor to waive lien rights for itself and any subcontractor. This reduces the effectiveness and importance of the mechanic's lien law in these states. Subcontractors and suppliers should always be aware of these types of waivers in determining whether to supply labor and materials to a project, at what price and whether to require some form of alternative consensual security.

TRUE MECHANIC'S LIEN LITIGATION

Construction clients are used to mechanic's liens. They pay five hundred dollars to a lawyer to file a mechanic's lien. Somebody later telephones the lawyer to pay off the account and everybody moves on to the next case. Once in a while the lawyer tells the client they do not have mechanic's lien rights. Even worse, once in a while the client pays five hundred dollars to a lawyer who later tells the client their mechanic's lien has failed for some reason. However, these are all examples of "glorified demand letters," not really mechanic's liens.

One day, the client is unhappy to receive a legal bill of thousands of dollars from the lawyer. Even worse, all of the opposing lawyers in the case keep writing legal papers and arguing about all the errors in the mechanic's lien and why the judge should dismiss the case and release the mechanic's lien. After six months and twenty thousand dollars in legal fees, the lawyer advises the client to settle for 75% of the claim. The client is disappointed. They thought they had hired a competent lawyer. Now there is something wrong with the case. The lawyer screwed something up and is now trying to bail out. The client has paid a lot of money for this legal incompetence and is now being told to voluntarily give up part of their claim.

This is very unfair. The client supplied perfectly good construction materials. The debtor promised three times they would pay the bill in full. Why is the legal system so unfair? Why do lawyers make the legal system so complicated?

This is "true mechanic's lien litigation," not a glorified demand letter. The competence of the lawyer was the same throughout. The basic fairness was the same in each case. The client deserved to be paid. It would be unfair otherwise. The complications of mechanic's lien law were the same in each case. The difference is that the client had experienced only glorified demand letters. The client has now finally experienced true mechanic's lien litigation, which is a battle between innocents. The client is trying to make another innocent party pay the client's losses.

Battle between Innocents

Bankruptcy or insolvency is not a battle between the debtor and a creditor. It is a battle between creditors. Most creditors were foolish, but all are otherwise innocent. They all made the same mistake, doing business with the wrong debtor. All secured and unsecured creditors are entitled to be paid. Fairness and justice would dictate that they all get their money.

Bankruptcy or insolvency, however, is a battle between "innocents." The "bad guy" is gone. All that is left are "good guys" that never bargained for problems with the debtor. All of the "good guys" are now battling each other for the limited assets of the debtor available to any creditor. All of the "good guys" deserve to be paid. Some will *not* be paid. It will be unfair. "True mechanic's lien litigation" is a "battle between innocents."

Secured and unsecured creditors are certainly adverse. If a bank can prove it properly filed a UCC financing statement on accounts receivable, those assets are pulled away from the unsecured creditors. If a construction material supplier can establish mechanic's lien rights, this will give them "priority" in that particular receivable. That material supplier will be paid in full, leaving less for the secured bank and the unsecured creditors. If the material suppliers had failed to perfect mechanic's lien rights, however, this supplier would be another general unsecured creditor. This receivable would be snatched up by another mechanic's lien claimant, go to the secured bank or shared with other unsecured creditors. The debtor doesn't care which creditor gets this asset. The debtor will not get any of the assets.

When a client is pursuing true mechanic's lien litigation, the client is trying to appropriate to themselves one of the debtor's receivables on one construction project. The client is trying to avoid sharing that money with any of the other creditors. The client would even try to defeat another mechanic's lien claimant, if it meant more money for the client. The client would do this even though it would be very unfair to the other mechanic's lien claimant, who supplied perfectly good construction materials and who the debtor promised three times they would pay. This is why lawyers make the legal system so complicated, because clients pay them to do so. This is "true mechanic's lien litigation."

Often, the true mechanic's lien litigation is between a mechanic's lien claimant and a foreclosing bank that has already lost a great deal of money on the foreclosed mortgage. Sometimes, the true mechanic's lien litigation is between a mechanic's lien claimant and the debtor's credit line bank that has a security interest in all of the debtor's accounts receivable. In many states, the true mechanic's lien litigation is between multiple mechanic's lien claimants trying to claim a limited fund owed to the debtor on one particular construction project (in a defense of payment state, discussed above). In other states, the true mechanic's lien litigation is between a mechanic's lien claimant and an innocent owner that has paid a general contractor in full (not a defense of payment state).

Strictly Construed

Mechanic's lien law is statutory. The case law in most states says that the mechanic's lien law is strictly construed, being in derogation of common law (a change in common law). More precisely, the perfection (filing in the land records of the initial lien) is strictly construed, while the enforcement (through a lawsuit) is liberally construed.[19] While this rule does promise some leniency in enforcing and litigating mechanic's liens, lien claimants spend most of their time battling the strict construction of the statute to avoid dismissal of the lien and lawsuit.

There is also little doubt that legislatures[20] and courts[21] are both making it harder and harder to establish mechanic's lien rights.

Mechanic's lien statutes in all states are becoming more and more strictly construed by the courts. It is respectfully submitted that courts are strictly construing enforcement issues,[22] despite the historic case law that the enforcement of a mechanic's lien through a lawsuit should be liberally construed. As a result any litigator needs to be careful with case law. Mechanic's lien statutes date back to the eighteenth century. There is much older case law that indicates a generous leniency in favor of the mechanic's lien claimant. The consistent pattern in the last couple of decades however, is for the highest courts in each state to periodically enunciate a new rule interpreting the statute that makes it more and more difficult to successfully establish mechanic's lien rights.

This may be because the historic purpose of mechanic's lien statutes is no longer an important public policy objective, to promote the development of civilization out of vast wilderness. We have plenty of buildings now and not enough wilderness.

Defense counsels, of course, promote this trend by artistically forming new arguments to get mechanic's liens dismissed. Accordingly, this trend towards strict construction may be accelerating as the courts and each new generation of defense counsel can rely on a larger body of negative case law.

This risk and uncertainty is one of the main reasons lawyers will encourage your clients to carefully consider any settlement offer. Lien claimants do not want to establish a new precedent that results in dismissal of their lien. They also do not want to spend a great deal of time and money successfully arguing a case to the state supreme court, since they will usually not be able to recover their legal fees. Defense counsel has a large incentive to give a novel argument a try, especially if large amounts of money are involved. Why not give it a try? History teaches that it might work. Accordingly, defense counsel has a viable threat that they will try the case. Lien claimants have a realistic risk that they will expend much time and energy only to fail.

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[19] *Thompson v. Air Power, Inc.*, 248 Va. 364, 448 S.E.2d 598 (1994).

[20] District of Columbia Code Section 40-301.02.

[21] *United Rentals, Inc. v. Angell*, 592 F.3d 525 (4th Cir. N.C. 2010).

[22] *Westpointe Plaza II LP v. Kalkreuth Roofing & Sheet Metal, Inc.*, 675 A.2d 571, 109 Md. App. 569 (1996) [Maryland Mechanic's Lien 15% and 25% rules that the property was improved sufficiently in value are an affirmative part of the claimant's case that the claimant must allege in their petition and then prove to the court]; *Walt Robbins, Inc. v. Damon Corp.*, 232 Va. 43, 348 S.E.2d 223 (1986); *Mendenhall v. Cooper*, 239 Va. 71, 387 S.E.2d 468 (1990); *James T. Bush Construction Co. v. Patel*, 243 Va. 84, 412 S.E.2d 703 (1992) [all deed of trust beneficiaries and trustees and all parties that have a "substantial interest in the opportunity to challenge the validity of the mechanic's lien, or otherwise to litigate the elements of the lien" are necessary parties to a lawsuit to enforce a mechanic's lien. If a Complaint does not name a necessary party, it has failed to properly enforce the mechanic's lien. Once it is too late to file the enforcement lawsuit, it is also too late to add an additional party and the mechanic's lien is lost altogether].

Costs and Settlement of True Mechanic's Lien Litigation

This risk and uncertainty, together with the comparatively large cost of litigating a lien, are the reasons that 75% or 85% of the claim is a typical "good settlement" in "true mechanic's lien litigation." True mechanic's lien litigation is expensive.

You are essentially litigating multiple cases simultaneously. In fact most mechanic's lien lawsuits have multiple "counts." You have a basic contract case in which you must prove your "statement of account," that you supplied labor and material in accordance with the contract, without defects and on time. It is usually a good practice to plead an unjust enrichment or *quantum meruit* count in the alternative.[23]

Then you must also prove your mechanic's lien. You must prove your last day of work and that the lien was filed timely. Then you need to prove the lien identifies the correct property and property owner and that you have all "necessary parties" in the lawsuit. This typically means you need a title search expert witness. Then you may have lien "priority" issues in which you may need an appraisal expert witness to prove the value of the property with and without the improvements. Then you have a high chance of appellate appeals, because of the uncertainty and volatility in case law.

You will not get 75% of the claim unless defense counsel thinks you have a good lien, but you will never be able to completely assure a client of success. You will never get legal fees in a mechanic's lien case. It will be very rare that you get even legal interest, unless you take the case to full trial and judgment. Lawyers need to explain the "battle between innocents" and get the client away from the idea that they "deserve to be paid." Of course they deserve to be paid, but that is irrelevant. The other innocent in the case deserves to avoid being forced to pay twice for the same construction labor or material. The "bad guy" is gone. It is unfair, but it is better to get 50 cents on the dollar than to get nothing.

It is also unusual that lien claimants have no chance. You typically talk in terms of ranges and percentages. You may think one or more defenses are "not worth anything," while another defense is a "risk that lowers the settlement value of this case." Some cases are "worth 95 cents on the dollar." In some cases 25 cents on the dollar is a great settlement. It is unusual that a case is worth nothing. A part of the lawyer's job as to evaluate whether a case is so worthless that it should not even be attempted or valuable enough to push another day or another month.

RESOLUTION OF MECHANIC'S LIEN CASES

Settlement of Subcontractor Claims

Once an owner has received notice of subcontractor mechanic's liens in a defense of payment state, the owner should make sure that all subcontractor mechanic's liens are in and the project is fully complete before the owner makes any distribution to subcontractors. The owner wants to protect its right to complete the building, by making sure that the building is truly complete and all defective work is corrected while still holding the money. The owner must also wait long enough to be sure that all subcontractor liens have been filed. Accordingly, the owner must wait at least 90 days after the project is truly complete before offering any payment to subcontractors.

This is often frustrating for a subcontractor who files a lien early in a project, but an owner really has no choice. An owner should make sure that it has provisions in the general contract to deal with this situation, including the right to withhold further payments to the general contractor.

Such cases can often be settled by some sort of voluntary payment by the owner. In a defense of payment state, this payment must usually be split up pro rata by all subcontractor lien claimants. All subcontractors normally must agree to take the same percentage partial payout to release their mechanic's liens, although this is a matter of business negotiations. All lien claimants must agree to release the owner and the property in exchange for the partial payout. If the subcontractor lien claimants are satisfied that this is all the owner owes, then this is all they would receive in litigation because of the owner's partial defense of payment.

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[23] *See* chapter, Equitable Remedies; section, Quantum Meruit and Unjust Enrichment.

The general contractor, if it still exists, must also agree to any settlement. In fact, all possible players in future litigation must agree to a voluntary settlement. This is often the impediment to a settlement without litigation. All subcontractor claimants are actually adverse to one another, if there is not enough money to pay all subcontractor claimants in full. If there are more valid subcontractor mechanic's liens, each subcontractor will get a lower percentage payout. Each subcontractor mechanic's lien found to be invalid will leave more money for the valid mechanic's lien holders.

To get a voluntary settlement without litigation, all subcontractors often must essentially agree to treat all liens as valid. This may be worthwhile to avoid the costs and delay of litigation. If one subcontractor feels that another subcontractor's lien should be disregarded as invalid, it is unlikely that a voluntary agreement can be reached. It may be necessary to have a judicial determination as to the validity of the liens.

If there is no defense of payment, then the owner's property is liable to all subcontractors. It is usually not so important to the owner or claimants to include all claimants in any settlement discussion. Each claimant may have better success talking to the owner alone and the owner can be more comfortable resolving just one subcontractor claim. However, if the general contractor still exists, it must still agree to any settlement. The owner and general contractor have contract relations that are impacted by the settlement with the subcontractor.

Payment of Indebtedness into Court

If the owner has a defense of payment, the owner should only have to pay for the project once. All subcontractor mechanic's liens will be valid only to the extent that the owner still owes funds to the general contractor. The owner should have the right to pay that indebtedness into court so that it may be split up among the various subcontractor competitors. This limits the owner's liability to what it should be and relieves the owner of the need to expend time and attorney's fees monitoring the litigation.

This resolution will be effective only if all subcontractors agree on the extent of the owner's total indebtedness. If any subcontractor disputes the status of accounts between the owner and general contractor, the court will not release the owner without some further proceeding. It may still be possible, however, for the owner to request the court to hold an evidentiary hearing on this single issue, relieving the need for the owner to participate in further proceedings concerning the status of accounts between the general and subcontractors, the validity of all subcontractor mechanic's liens and other issues.

Removal of Mechanic's Lien

Once a mechanic's lien has been filed, an owner has the important option of doing absolutely nothing. In most states, there is a duty not to pay the general contractor once a lien has been filed, or the owner is at risk for paying twice. The lien will stay on the property until the lawsuit to enforce is due. This may not cause a practical problem, unless the owner intends to sell the property, refinance a loan or take construction loan draws. The mechanic's lien claimant must file a fairly expensive Complaint to Enforce the Mechanic's Lien. This may never happen. If the lien is not enforced, it will be extinguished or can be easily removed.

A mechanic's lien will not necessarily stop a construction project or keep an owner from selling the property. While these results are often the practical effect, the owner still has other options.

Construction lenders will be concerned about a mechanic's lien because it can have priority over a construction loan.[24] The construction lender can and often will inform the debtor that no further construction draws will be made until the lien is released or bonded off. If the mechanic's lien amount is very small in comparison to the construction loan, and the lender is well secured, however, the lender may not be concerned with the mechanic's lien.

Similarly, a real estate purchaser will usually insist that a mechanic's lien be removed before they will buy the property. This is by no means required, however. The property can be sold "subject to" the mechanic's lien, meaning that the mechanic's lien is still on the property after the sale. This will sometimes happen when a real estate seller and purchaser are closely related. This could also happen if the mechanic's lien amount is very small, and the purchaser is willing to take the seller's assurances that the seller will defend against the lien if necessary. If the purchase price is advantageous enough, a purchaser may simply decide to take the risk.

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[24] *See* section above, Priority.

If a mechanic's lien must be removed from the property, there are three basic choices:

1. Negotiate a release with the mechanic's lien holder
2. Request the court to release the mechanic's lien
3. Provide a bond in place of the mechanic's lien.

Negotiated Release of Lien

If an owner must obtain a release of the mechanic's lien, the owner may simply telephone the mechanic's lien holder and negotiate a release. In the case of a subcontractor mechanic's lien, the owner may be willing to issue a direct check to the subcontractor or a joint check with the general contractor. If a general contractor has liened the property, the owner may now be willing to negotiate with the general contractor to reach an agreement on the status of accounts.

The mechanic's lien does provide the contractor some leverage and may help the contractor get a "better deal" than was previously offered. A contractor should be careful not to overuse this leverage, however, because the owner does have other options. If a contractor pushes too hard, an owner will decide simply to incur the expense of getting the lien released without the agreement of the contractor.

Court Ordered Release

Under most state codes,[25] a property owner (or other person with an interest in the property) can request a "summary hearing" or a "quick hearing" on the validity of the mechanic's lien.[26] This will often succeed if there is a simple or easily understandable problem with the mechanic's lien. For example, the mechanic's lien claimant may have named the incorrect owner on may have signed mechanic's lien waivers or releases.

The owner need not wait for the case to mature on the normal trial docket, as this could take a year or more. An owner can often get a summary hearing within weeks. If the issue is not clear-cut, however, a court is likely to decide that a more complete hearing is necessary, and this will cause delay. The court may decide that the mechanic's lien claimant is entitled to pretrial discovery and time to prepare for a complete hearing.

In the case of a subcontractor mechanic's lien, the owner may be able to demand that the general contractor have the lien removed. The general contractor may prefer using a summary hearing, instead of incurring a bond premium, as discussed below.

Mechanic's Lien Bond

The fastest and surest way to remove a mechanic's lien from the land records is to "bond off" the lien.[27] The property owner, the general contractor or any other party in interest can normally accomplish this. It is not necessary to prove anything, and the court need not make any hard decisions. In this procedure, the court will remove the mechanic's lien from the property, but the mechanic's lien is replaced with cash or a surety bond, something just as good to the claimant.

The cash or surety bond assures the mechanic's lien holder of payment, if the mechanic's lien holder can prove that it had a valid, enforceable and collectable mechanic's lien. It will still be necessary for the mechanic's lien holder to prove all aspects of the mechanic's lien case, including the existence of a debt, timely filing of the mechanic's lien, the relative priorities of all enforceable liens against the property, etc.[28] The mechanic's lien holder must still file a timely Complaint to Enforce Mechanic's Lien. It will normally be necessary to name the surety as a party defendant.[29] It may no longer be necessary to name the property owner, all lenders and trustees on deeds of trust.[30] In other words, there may be less "necessary parties" after a lien has been bonded off, since the lien can no longer affect the parties' interest in the real estate.

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[25] Virginia Code §43-17.1 (Michie 1950).

[26] *See e.g., Pic Constr. Co. v. First Union Nat'l Bank*, 218 Va. 915, 241 S.E.2d 804 (1978).

[27] Virginia Code §43-70 or §43-71 (Michie 1950); DC Code Section 40-303.16; Maryland Real Property Code Section 9-106(c).

[28] *York Federal Savings & Loan Assoc. v. Hazel*, 256 Va. 598, 506 S.E.2d 315 (1998).

[29] Va. Code Anno. §43-71 (Michie 1950).

[30] *George W. Kane, Inc. v. Nuscope, Inc.*, 243 Va. 503, 416 S.E.2d 701 (1992).

To judicially bond off a mechanic's lien, a property owner or general contractor will incur the cost of petition filing, one attorney court appearance and a bond premium. Since this process is so fast and so certain to succeed, however, it is often the best choice to get a mechanic's lien released.

Because of the expense of judicial bonding, a practice of non-judicial bonding has developed in some states. Many owners, lenders and sureties are satisfied with an informal bond that does not involve the court or appear in the land records. A surety company will provide a bond to a title company, the owner or the lender. The owner, lender or title company may then be willing to allow payments or loan draws to continue. The mechanic's lien will remain of record, but the bonded party will have protection in case of a judgment for the claimant. A claimant may never know that an owner or other party has been non-judicially bonded since the claimant is not entitled to notice of this process.

CONCLUSION

Construction contractors and suppliers are fortunate to have special forms of judicial security. The most important are mechanic's lien and payment bond rights. The security rights in each state warrant special attention and will be discussed in greater detail in separate chapters of this book. For example, while Virginia law provides a relatively powerful mechanic's lien that will not be lost in bankruptcy, Maryland has a lower priority mechanic's lien that will be lost in bankruptcy. You must understand these differences to be able to assess the security and risks you have in each transaction.