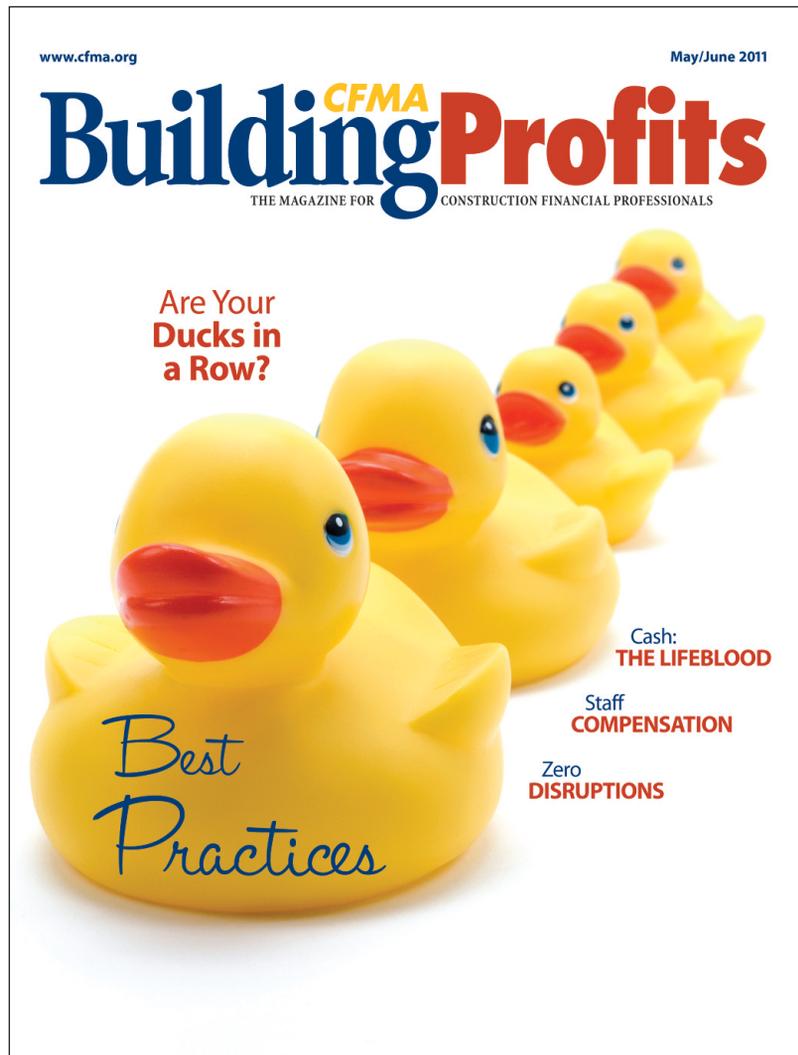


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Lien Laws & Out-of-State Projects: A Little Research Goes a Long Way

Your company, like many others in construction, is likely experiencing the effects of the prolonged economic downturn and wondering if there's an end in sight. Some states are starting to show small upticks in economic activity, but perhaps not yours. This might lead your company to consider looking for work in other states.

As your company ventures into other territories, you apply your existing lien law knowledge to out-of-state projects. However, as an out-of-state job approaches completion, something goes horribly wrong. Perhaps there is a change order dispute with a subcontractor who liens the project, which causes the owner to withhold payment from you.

Naturally, you attempt to lien the project too. But, the out-of-state lien law is very different than what you thought, resulting in an inadvertent failure to perfect your company's lien rights. Even worse, your subcontractor perfected its rights and was paid by the owner to satisfy its lien, so now you must defend the inevitable claim from the owner for sums paid to the lienor.

What went wrong? Your unfamiliarity with the out-of-state lien law gave your subcontractor an unfair advantage when it perfected its lien for sums to which you believe it was not entitled. And, your company's ability to resolve the payment dispute was compromised by the loss of benefits otherwise provided by that particular state's lien law.

Unfortunately, this scenario happens all too often. As contractors expand their business into other states, they seldom consider the differences in lien laws from state to state.

Although lien laws differ significantly, most generally address the same topics. With a little research, you can learn about the most pressing provisions and perfect your company's rights.

Protected Class of Lienors

Identify who is entitled to lien rights. There is general uniformity throughout most states, with only a few variations. Most lien laws afford rights to contractors, subcontractors, subs, and material suppliers. Some also provide rights to individual laborers.

It's important to discover how far lien rights extend down the

hierarchy of contracts. For example, most lien laws protect design professionals, but some do not. Some states give lien rights to certified appraisers, but most do not. And, in some states, the protected class of lienors differs depending on whether the project is residential or commercial.

So, determine the class of potential lienors before a project begins. This will help identify the entities from which you must obtain appropriate releases as the project progresses.

Contract Requirements

You should also review the validity of the standard contracts your company sends to its clients, subcontractors, and suppliers in light of local lien law requirements.

Verbal Contracts

Most state statutes permit verbal and written contracts, but some states limit the enforceability of verbal contracts. For example, many states require a written contract if a project cannot be performed in less than one year or involves the sale of goods exceeding \$500. If you come from a state where all verbal contracts are enforceable, you may be surprised if a verbal contract is prohibited in another state.

Pay-if-Paid Clauses

Under "pay-if-paid" clauses, a contractor is not required to pay subcontractors unless the contractor received money from the owner. Some states freely enforce these clauses, some prohibit them as against public policy, and still others enforce them under limited circumstances. So, you must determine the enforceability of your company's standard contracts before using them in unfamiliar states.

Required Warnings or Disclosures

Be aware of unusual procedures or warning requirements that differ significantly from your home state's. There are some that could jeopardize your company's lien rights before work on a project even starts.

For example, on most residential projects in Florida, a contract between an owner and a contractor must contain a warn-



ing provision in no less than 12-point, capitalized, boldface type on the front page of the contract or a separate page that must be signed by the owner and dated, alerting the owner to the lien law and how it operates.

Kansas permits liens on new residential property after a purchaser buys the property, provided the lienors first record a Notice of Intent to Perform in the office of the district court where the property is located before the deed passing title to such property is recorded.

In Missouri, subcontractors are not entitled to liens on owner-occupied residential property of four units or fewer unless the GC first obtains consent from the owner in a written contract, wherein the owner agrees to be liable for such costs if they are not paid.

In many of these instances, noncompliant contractors would lose their lien rights before the job starts.

Preliminary Notice to the Owner

As a prerequisite to lien rights, almost every state requires lienors to send some form of preliminary notice to the owner early in a project. The preliminary notice introduces the lienor as a potential claimant from whom the owner must obtain releases of lien.

However, the forms and requirements for service of these preliminary notices vary drastically from state to state. For example, in New Jersey, before filing a lien arising under a residential construction contract, a lien claimant must first file a Notice of Unpaid Balance and Right to File Lien within 60 days after the last date that work, services, materials, or equipment were provided for which payment is claimed.

In Wyoming, a GC must post a notice on the construction site notifying lienors that a notice of the right to claim a lien must be served on the contractor. The lienor will lose its lien rights if it fails to comply.

And sometimes, depending on the type of work and the classification of the lienor performing the work, more than one notice is required. Texas requires different preliminary notices, which may be governed by different timeframes, depending, for example, on whether or not the lien involves specially fabricated goods.

Recording Liens

Lien recording requirements also vary. In Vermont, a construction lien is valid for only 180 days from the time payment became due for the last of the lienor's work, unless a notice of such lien is filed in the office of the town clerk.

On the other hand, Florida requires claims of lien to be recorded within 90 days of the last day of work on the project and served upon the owner within 15 days of recording.

Mandatory Language & Deadlines

Many states require specific lien language. If your company's lien form does not comply with a state's mandatory language, then the lien may be invalid and unenforceable. Find out the deadlines for recording a lien, the notices that must be served around the time the lien is recorded, the lien form that must be used, and the deadline for serving the lien on the owner.

Lien Foreclosure Actions

By the time you contemplate suing to foreclose on a lien, your company has probably retained an attorney familiar with that state's laws. Nevertheless, pay attention to deadlines and other lien foreclosure requirements.

While many states allow a lawsuit up to one year from the date on which the lien is recorded, Louisiana's foreclosure deadline is one year after expiration of the applicable time period to record a lien, regardless of when the lien was actually recorded.

In Idaho, a lien expires if contractors don't sue to foreclose on it within six months from the date on which it was filed. This time can be extended by a partial payment or extension of credit after the lien was recorded.

To prevent a lien from expiring, most states require a notice of *lis pendens* (suit pending) to be recorded in the public records with the filing of a foreclosure action. So, review state deadlines for filing suit on a lien and give your attorney sufficient time to prevent the lien's inadvertent expiration.

Transfer Bonds

In some states, liens may be removed from property by filing a transfer bond, but these laws also vary significantly.

In Connecticut, any interested party may substitute a bond in lieu of the lien only after obtaining court approval. The court will decide the good faith intent of the interested party to contest the lien and the sufficiency of the surety bond before the bond may be substituted for the lien. In contrast, other states allow an owner to transfer a lien to a bond as a matter of course without the court's approval.

The deadlines by which to sue on payment bonds also vary. Some states have deadlines as short as 90 days, while others allow one year from the last day of work on the project.

Many states permit an interested party to transfer a lien to a bond

at any time, while other states preclude such a transfer once a foreclosure action has been filed. In Oklahoma, any interested party can discharge a lien by depositing either cash or a surety bond in an amount equal to 125% of the lien. If cash is deposited, the clerk will immediately show that the lien is released.

However, in the case of a bond, the lienor may object to the bond within 10 days, which will require a court hearing on the validity of the objections.

Each state also has its own formula to compute the required bond amount to transfer liens. So, research the procedure to transfer liens to bonds and/or consider other forms of security when working in an unfamiliar state.

Sworn Statements of Account

Some states have specific provisions regarding the exchange of written sworn statements of a project's accounting. In Arkansas, a claimant may be fined up to \$2,500 if:

- Upon request, it fails within five business days to give a correct list of the parties furnishing material, labor, or services, and the amount due; or
- It falsely certifies that the owner or its agent has received the preliminary notice under the lien law.

In many states, failure to respond to a request for a sworn statement of account within a specified time period results in a complete loss of lien rights. In Michigan, the failure to provide a sworn statement does not render a lien invalid; however, the lienor is not entitled to any payment and may not sue to enforce the lien until the sworn statement has been provided.

In many states, submitting a false sworn statement may result in criminal liability. Requests for sworn statements of account are regularly used on projects throughout the country, so be sure to understand the statutory procedures that govern them before your company begins work in an unfamiliar state.

Fraudulent Liens

Florida has a statute that addresses fraudulent liens, defined as liens to which: 1) the lienor has willfully exaggerated the lien amount, 2) the lienor has willfully included a claim for work not performed upon the property, or 3) the lienor has compiled his or her claim with such willful and gross negligence as to amount to a willful exaggeration.

Ramifications of fraudulent liens usually include voiding the lien and may include affirmative claims for damages against the lienor by the property owner. Some states make fraudulent liens a criminal violation, which may be grounds for disci-

plinary proceedings against the lienor's construction license.

Given the serious consequences of incorrectly compiling a lien, you should know the standards, ramifications, and defenses for fraudulent liens in each state where your company performs work.

Miscellaneous Provisions

Although this article addresses some prevalent lien law provisions, many states include other provisions that could impact contractors. For example, some states have specific statutes regarding the use and misappropriation of construction funds and the ramifications of failing to pay subcontractors and suppliers after a contractor receives payment from the owner.

Many states also have specific statutory provisions that address releases of lien and the manner in which they may be used. A number of states have statutory provisions that permit an owner to drastically shorten a lien foreclosure deadline before the lien automatically expires.

Such provisions could significantly impact your company's rights and liabilities.

In Summary

While it seems daunting, a little research can help you master out-of-state lien laws and avoid unpleasant surprises at the end of the job. Past experience in one state is almost never enough to protect your company's lien rights in another.

- 1) *Types of property interests subject to liens:* Is the project exempt from lien laws? Projects may be exempt or have limited lien rights (e.g., public projects, construction performed for a tenant, work approved by one spouse when both own the property).
- 2) *Multiple liens when working on multiple lots:* If your company needs to lien a platted subdivision project, do you record a single lien for the entire subdivision or separate liens for each lot? If the latter, then how do you determine the lien amount for each lien you record?
- 3) *Obligation to disclose information:* Is your company compelled to disclose its subcontractors and suppliers to its clients? And, do your subcontractors have to make disclosures to your company?
- 4) *Involvement of construction lenders:* Do you understand the role construction lenders may play on the project and how those roles impact the lien law?

This is especially critical in the current economy, where mortgage foreclosures are wiping out junior liens. Find out what you can do during the project



to provide your company possible recourse against a lender at the end of the job.

- 5) *Conditional payment bonds:* Some states authorize conditional payment bonds in which the sureties will pay the lienors only if the bond principal (usually the GC) has been paid for the lienor's scope of work. ■

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