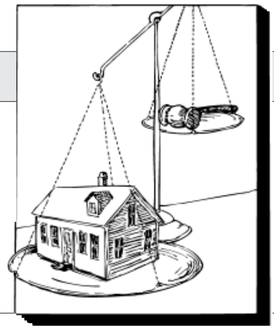
# Protecting Lien Rights



by Perry Safran and James Fradenburg

Lien waivers are usually provided by contractors to owners at the time of a progress payment or final payment. The waiver certifies to the owner that the contractor has paid all employees, suppliers, and subcontractors connected with the project. This protects the owner from being double-billed — once by the contractor and again by a supplier or sub who was never paid by the contractor.

Occasionally, however, contractors supply false lien waivers to further their own ends at the expense of subcontractors. Until recently, subcontractors could not get relief from the courts — even when they had filed a mechanic's lien on the owner's property — if the general contractor had provided a lien waiver. The current trend, however, is toward protecting a sub's lien rights, although success depends on the type of lien and the facts of the case.

***False lien waiver.*** In *Metropolitan Life Insurance v. C. E. Rowell*, Rowell, usually a subcontractor, entered into a contract agreement directly with the owner and developer of an apartment project in Charlotte, N.C. After Rowell had begun work, the owner hired a general contractor to oversee the project. The GC only visited the job site once or twice, however, and never provided any substantive work to the project.

Ten days before Rowell's last day of work, the owner granted a deed of trust to Metropolitan Life to secure a $1.7 million loan. As a part of the transaction, Metropolitan required the general contractor to execute a lien waiver affidavit stating that all subcontractors had been paid in full, despite the fact that Rowell had not yet been paid. Rowell filed a claim of lien, and in the ensuing suit, Rowell got a judgment for the amount owed ($267,700). As a part of the judgment, the court ordered a foreclosure sale of the property to satisfy the judgment.

***Two types of liens.*** While Metropolitan had no standing in Rowell's suit against the owner, as holder of a deed of trust to the property, it objected to the foreclosure sale. Metropolitan filed suit claiming priority over Rowell's judgment, an argument that hinged on the important differences between a mechanic's lien and a judgment lien.

A mechanic's lien is a claim against real property, and must be filed and "perfected" in a suit within a specified amount of time from the completion of work. A judgment lien, on the other hand, is created when a party obtains a judgment in court and then attempts to execute the judgment against real property. Also, a mechanic's lien is provided for by statute, while a judgment lien arises from a court order. Finally, a mechanic's lien dates back to the "first furnishing" of labor and material, while a judgment lien dates to the time of docket entry.

At trial, Metropolitan tried to show that Rowell's judgment was not based on a mechanic's lien, but on a judgment lien. A mechanic's lien would relate back to the start of Rowell's work. This would mean that Rowell would have to be paid before Metropolitan could enforce its deed of trust, which was granted only shortly before Rowell finished his work. If Rowell's judgment was a judgment lien, however, Metropolitan would have priority and proceeds from the foreclosure would satisfy Metropolitan first.

The trial court agreed with Metropolitan's claim that the deed of trust had priority over Rowell's judgment lien. Since there wasn't enough money to satisfy both the deed of trust and the judgment lien, Rowell was left without any payment.

***Lien rights protected.*** Rowell appealed, and the Court of Appeals reversed the trial court ruling in the foreclosure case. In the appeal, Metropolitan again tried to show that Rowell's lien was a judgment lien, arguing that it contained items that cannot normally be recovered under a mechanic's lien. For example, Rowell's lien included a bill for $20,000 plus interest from a lumber supplier, as well as travel expenses at a rate of $150 per week. Neither of these items is recoverable by mechanic's lien, because neither directly impacted the real property.

Rowell argued that he had contracted directly with the owner — not as a first-tier subcontractor — so his lien rights could not be waived by the general contractor. The court agreed, and ordered Rowell's judgment to be satisfied out of funds from the foreclosure sale.

In its ruling, the Court of Appeals refused to question the discrepancies in Rowell's lien as cited by Metropolitan, because the issue was not properly raised by the owner in the original trial. The ruling is consistent with a trend toward protecting the priority of a subcontractor's lien rights, which are constitutional in North Carolina and many other states.

Rowell argued that he had contracted directly with the owner, so the G.C. could not waive his lien rights. The court agreed.

The case has two important results for subcontractors and general contractors. First, it refused to allow a lender to rely on a false lien waiver by the general contractor to cut off a subcontractor's lien, a practice common in the industry. Second, it refused to allow a lender to challenge a lien as defective when the borrower failed to appeal a judgment.

Contractors and subcontractors should consider carefully what they include and exclude in a mechanic's lien, based on this case. In general, materials included in a mechanic's lien must directly improve the real property liened upon. Similarly, claims for labor must be for actual work performed by the claimant that directly affects the real property in question. ■

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