

Leverage When it Counts

When owners and GCs won't pay up, electrical contractors can 'lien' on the law if they follow it to the letter and apply it correctly

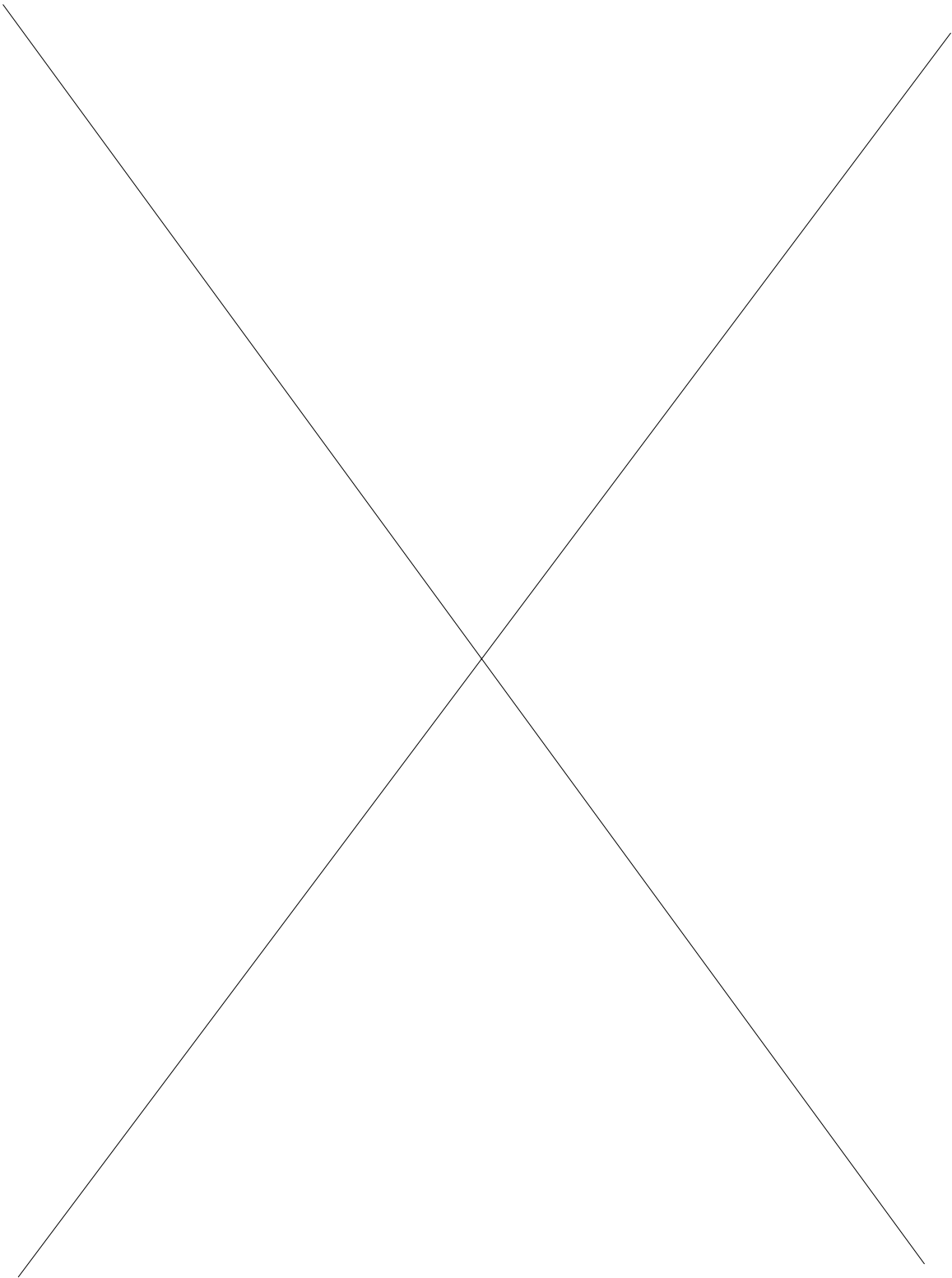


A lawyer with a strong knowledge of construction law may be your only option to ensure payment.

By **Matthew Halverson**, Managing Editor

Tom Connor used to do business with a handshake and a gentleman's agreement. The president of the 10-man, Nashville, Tenn.-based McCullough Electric specializes in the installation and maintenance of printing press equipment, and most of his work comes from repeat customers whom he trusts, so putting things in writing was never a priority. Although good for building relationships, that neighborly work practice could have cost him more than 15% of his firm's average yearly revenue when a general contractor for whom he'd been working in the Winter of 2002 went out of business and stiffed him on nearly four months' worth of work. "It got pretty thin there when we weren't receiving any payments at all," Connor says.

With such a small outfit, Connor didn't have a lot of weight to throw around to try to get what was owed to him. Pulling off the job wouldn't have helped him get paid any sooner, and contacting the general contractor to demand payment was difficult because the firm was based in Germany. "I'd try to catch them in the morning in the few hours that they were there, and there'd be nobody there who could speak English," he says.



Terms of Entitlement

Lawyers have a language all their own. Anyone who's ever read the fine print in a contract or studied a court brief knows it can be difficult to follow along unless you've passed the bar exam. There's no substitute for an attorney when trying to translate the law, but it can't hurt to know the following terms that pop up often in lien law cases. (*Source: Law.com*)

- **encumbrance** – n. a general term for any claim or lien on a parcel of real property. These include deeds of trust, recorded abstracts of judgement, unpaid real property taxes, tax liens, and mechanic's liens. While the owner has title, any encumbrance is usually on record and must be paid for at some point.
- **improvement** – n. any permanent structure or real property, or any work on the property that increases its value.
- **interest** – n. any and all partial or total right to property or for the use of property, including an easement to pass over a neighboring parcel of land, a possibility of acquiring title upon the happening of some event, or outright title.
- **perfect** – v. to complete; to take all required steps to achieve a result, such as obtaining a lien or other security by legal action or completing and filing all documents to present a case.
- **privity** – n. contact, connection, or mutual interest between parties. The term is particularly important in the law of contracts, which requires that there be "privity" if one party to a contract can enforce the contract by a lawsuit against the other party.

Despite that seemingly impossible task, though, he still had one weapon at his disposal: a lien. Even the smallest contractor is entitled to the same protections under each state's lien laws, and oftentimes that recourse is a company's only option when trying to secure payment.

Although it can be helpful, a lien isn't without its limitations. The same construction law attorneys who hail liens as the saving grace of subcontractors who have trouble getting paid are also quick to point out that those rights aren't ironclad. Exerting a lien doesn't guarantee payment, the requirements for filing one vary greatly from state to state and can be tricky to navigate, and even if they're successful, it can still take years to get paid. Even the most clear-cut cases can be undermined by missed deadlines and incomplete paperwork. "It's not a magic bullet," says Chris Dunn, a construction law attorney with the Nashville-based Waller Lansden Dortch & Davis firm and the attorney who advised Connor on his lien case. "But someone who's knowledgeable about

their lien rights is inevitably going to get paid before someone who isn't."

That's why Dunn and Frank Riggs, a partner in the construction law department of the Smith, Currie & Hancock law firm in Atlanta, say it's imperative that subcontractors know the specifics of their state's lien law before they find themselves in a nonpayment situation. "There are a lot of contractors who assume they only need to understand the lien law when they have a problem," Riggs says. "But if you wait until you have a problem to try to understand what your rights are, it might be too late."

A powerful tool... The cynic might say that lien laws are written in such a strict and complicated way to intentionally trip-up the subcontractor who dares file one. But Dunn says they're written that way because they give the claimant (i.e. the subcontractor) a powerful remedy that can produce dramatic effects. In many states, a successful lien claim gives the claimant an interest in the owner's property and the right to have it sold to satisfy

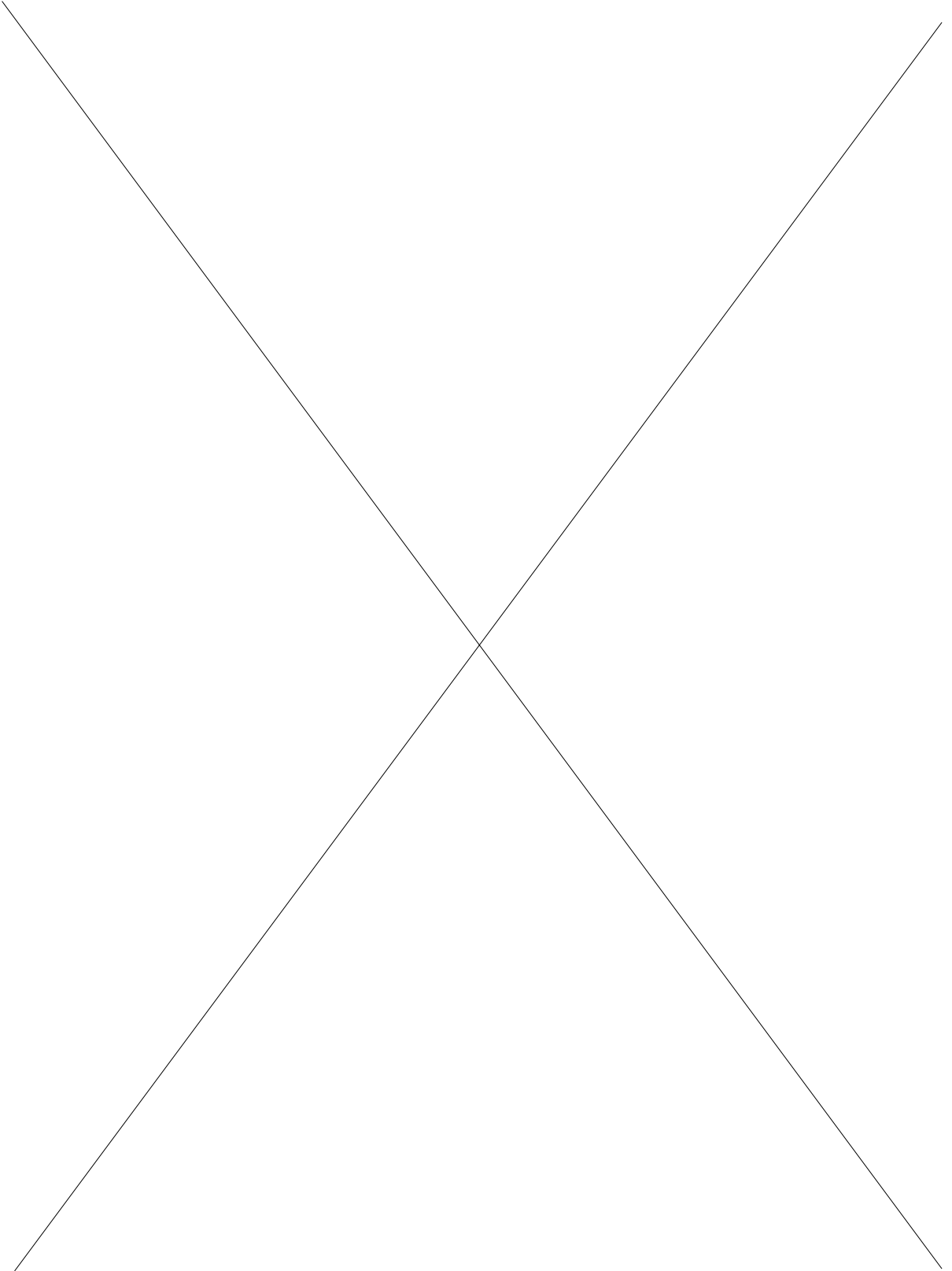
the debt. "This type of relief is really extraordinary, especially when you consider that a subcontractor claimant might not have a contract with the owner," he says. "And that's why you find the rules to be so stringent."

Rarely does a lien claim make it that far, because oftentimes even the threat of one is enough to get the attention of other parties that have an interest in the property, namely the owner's lender. If and when a lien is filed with the county, it creates an encumbrance against the property, which could prevent the owner or lender from later selling it ("**Terms of Entitlement**" at left). And the last thing a lender wants is for someone else to have a stake in its investment. "The principle value of the lien for subcontractors is that it oftentimes causes problems for the owner's lender," Riggs says. "So it gets someone's attention."

In short, it gives the subcontractor leverage it might not normally enjoy. Consider any new large construction project. Chances are the owner will have to take out a sizeable loan from the bank, so if it fails to pay for work on the project and the subcontractors file liens against the property, the bank will no doubt sit up and take notice. "That bank is liable to say, 'We don't like the fact that ACME Electric now has an interest in our property and might be able to force a judge to sell it, so get this resolved,'" Dunn says.

...If you play by the rules. Of course, that's all dependant upon a properly filed claim—a task that's not always easy to complete. For starters, it may be necessary to take steps at the beginning of a project—before there's even any indication that payment issues could arise—to preserve lien rights in the event that a claim becomes necessary down the road. "If you wait too long and try to recapture those rights at the end of the project, it could be too late," Dunn says. "So getting the right information and getting it early is crucial."

In states like Michigan and Oregon, a subcontractor must make itself known to the owner by sending a notice that it's involved in the project and that work has begun. Failure to do so can cause the contractor to forfeit its rights to a lien later on. These so-called "front-end loaded"



Taking the Lien Law to Court

The case of Gem Plumbing v. Rossi doesn't involve any electrical contractors, but it could affect them just the same. Last year the Rhode Island-based plumber filed a lawsuit to enforce a lien against the owners of a commercial office building in Smithfield, R.I., for \$35,000 in unpaid labor and materials. After paying off the debt, the owners, Robert and Linda Rossi, were successful in arguing to the court that the state's lien law was unconstitutional because it compromised and interfered with property interests without adequate procedural safeguards and didn't provide a timely means for removing the lien. The plumber is appealing the decision to the state's Supreme Court, and Brian Cabbage and the ASA are looking on with interest.

The brief filed by ASA in March urges the state Supreme Court to overturn the lower court's ruling based on the fact that the owners were aware of the law when they signed the construction contract with Gem. "It's the same as when you take your stuff down to a storage locker," Cabbage says. "You can claim later that you didn't know that the owner could take your stuff and sell it to pay for the storage costs if you didn't pay any bills for a year, but nobody's going to feel sorry for you."

A decision in the case is expected in the next year.

states put the burden on the contractor to take steps to let the owner know they're there so the owner can ensure that they get paid. "Owners want to know who all of the subcontractors are so they don't come crawling out of the woodwork at the end of the project," Riggs says. "He doesn't want to pay the general contractor and then find out that the general contractor hasn't paid a sub."

While some states require the necessary paperwork to be filed before construction begins, every state imposes deadlines for claims to be filed after construction ends—but they can range from 75 days after completion to a "reasonable amount of time."

Both situations illustrate one of the most important points for a contractor to understand: lien laws vary greatly from one state to the next. The first thing construction attorneys—including Riggs and Dunn—say when asked a specific question about liens is, "It depends on the state." Even if you're familiar with the requirements in your state, that doesn't mean you're prepared for work in a neighboring state. Because so many contractors perform work in multiple states, Riggs stresses the importance of learning where the differences lie. "Contractors can get themselves into trouble when they wander from state to state without first

trying to identify what the new state's lien law is," he says. "So when you're going to a new jurisdiction, it's almost mandatory that you contact someone who understands the lien law there and say, 'What do I need to know?'"

That typically means consulting your attorney. And although small contractors may not always have the money to retain a lawyer, Dunn says they can still benefit from having one help them structure their contracts to prevent problems if they're one

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day faced with a nonpayment situation. A good contract can't ensure that a contractor will get paid, but if it includes well-defined terms, it can make it easier to secure payment if a dispute arises. "There are some lien laws that may require you to give a certain notice within a certain number of days of project completion,"

he says. "But if you didn't define 'project completion' well in your contract, it makes it more difficult to execute a lien."

An attorney is always a good person to start with when looking for information on jurisdictional differences in the law, but contractors have other options at their disposal as well, among them the American Subcontractors Association (ASA). Brian Cabbage, ASA's construction law and contracts counsel, says the association was established for that very purpose. "What issue do all specialty contractors have in common?" he asks. "They all have difficulty getting paid. The ASA pretty much exists for payment issues."

Aside from advising its members on their rights and helping them draft liens, ASA is involved in cases that could have a bearing on the future of lien legislation. In fact, it just recently filed a "friend of the court" brief in a Rhode Island appeals case in which a trial court found liens unconstitutional under the due process clause of the U.S. Constitution. "That's something that could affect all subcontractors despite the fact that lien laws are different all across the country," Cabbage says. "When you consider the effect of the Federal Constitution, that's something that affects everybody nationally."

Sweet relief. Despite having a good relationship with the owner of the printing press, Tom Connor had to file a lien against its property to help get his money. The owner was then able to use the lien as leverage against the German contractor, who eventually paid Connor. He estimates he was able to recover about 95% of what he was owed, but after paying off the loan he'd needed to stay open in the meantime, he only broke even on the job.

Although it was a cause of constant stress at the time, the situation made him realize it was time to tighten up his business practices. Even though contract terms didn't become an issue, he's done away with his policy of closing a deal with a handshake. And it provided him with a reminder of just how important it can be to know what your rights are. "Another one of the German subcontractors lost hundreds of thousands of dollars on the job just because they didn't know what to do," he says. "They didn't know how to protect their rights." EC&M