

Mechanics' Liens — An International Perspective

One of the most important concerns for any contractor is

receipt of payment. Wherever construction contractors seek opportunities, it is critical that they carefully investigate and understand their rights in the event of nonpayment. This investigation must start in the pre-bidding phase of a project. Although various legislatures in the United States have

assisted contractors and suppliers in dealing with the risk of nonpayment by enacting what are commonly called mechanics' lien laws, such statutory protections generally do not exist elsewhere. Even in the United States, the substantive protections afforded by these laws often vary dramatically from state to state. As a result, U.S. contractors performing work outside of the U.S. must typically pursue other means to ensure payment, and non-U.S. contractors performing work within the U.S. need to be aware of these laws to fully understand their payment rights and remedies.

Mechanics' Liens in the United States

In each of the states, there is presently some form of mechanics' lien law, but there is no uniform statute across the nation.¹ Notwithstanding, there are some common themes, and for the non-U.S. contractor, the following is a brief explanation of how such laws generally operate.²

In the context of private improvement projects, mechanic's lien statutes generally entitle a person that furnishes labor, material or services to a project to a statutory lien, or interest, against the real property being improved for the unpaid value of the labor, materials or services provided. No judicial determination of entitlement to the money claimed is required before the lien attaches to the property, and the property will stand as security for the debt owed to the unpaid contractor or supplier until such judicial determination is ultimately made and the debt paid. If the contractor or supplier files in a timely manner and serves the

mechanic's lien, it will have the legal right to sell the property to satisfy any amount ultimately adjudged by a court to be due. In the context of public improvements, the lien or interest attaches to the moneys due or to become due from the public entity to the prime contractor.³

Mechanics' lien laws can be very powerful and effective tools for securing

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payment. In the case of an unpaid subcontractor, it is very common for an owner to either withhold payment to the general contractor for the amount of the lien or require the prime contractor to post a surety bond to stand as security for the lien; for if the owner continues to make payment to the prime contractor after receiving notice of a mechanic's lien, the owner may be held personally liable to the subcontractor for any moneys due to it. Moreover, a mechanic's lien is secured by the real property on which the improvement was made. The fact that the real property can be the owner's most significant asset and that lien rights with their priority status survive any bankruptcy make them very valuable in securing payment.

However, it is not the similarities in the laws for which a contractor or supplier needs to be aware, but rather the subtle nuances and disparities in the laws, which create dangerous pitfalls for the unwary. For example, contractors are sometimes required by the terms of their contracts to waive their

mechanic's lien rights at the inception of the project, before any work or services are performed. Many states permit such contractual waivers; others do not. How the parties treat these rights in their contracts is significant lest an unsuspecting contractor waive rights that it did not even realize it had.

Co-existing with the lien laws in many states are what are commonly referred to as trust fund statutes. (*See insert on trust fund statutes on the following page.*) These statutes are similar to the mechanic's lien laws in that they serve to protect those that furnish labor, materials or services in connection with a construction project. Generally, pursuant to the trust fund statutes,

any money received by an owner, contractor or subcontractor from a lender (in the case of an owner) or from the party with whom it has a contract (in the case of a contractor or subcontractor) is held in trust for the benefit of its subcontractors and suppliers on the project, and must be first applied to pay off claims of those subcontractors or suppliers before being used for any other purpose (e.g., covering the contractor's own home office overhead or profit). Unlike the mechanics' lien laws, though, the unpaid party typically need not do anything special to perfect its rights. If the money received is not properly applied according to the statute, the contractor may be found to have unlawfully diverted construction trust funds, subjecting itself and its principals to civil or even possible criminal liability. Such trust fund statutes, however, are only as strong as the financial viability of the contractor to whom the trust money was paid — if that contractor becomes bankrupt, there may be no assets with which to pay the claim.

Since most non-U.S. jurisdictions do not provide for the nonjudicial applica-

tion of liens, non-U.S. contractors are advised to familiarize themselves with these mechanisms and seek the necessary advice to protect their payments. Conversely, though, U.S. contractors doing work abroad cannot simply rely upon their standard form contracts, drafted against the backdrop of these laws, but must seek alternate means of payment protection.

Mechanics' Liens Outside the United States

With only a few exceptions, countries, including Mexico,⁴ most of Latin America⁵ and the United Kingdom,⁶ do not recognize the concept of mechanics' liens.⁷ Further, while these jurisdictions merely do not recognize the concept of mechanic's liens, other countries such as the United Arab Emirates specifically prohibit subcontractors from directly claiming any moneys or damages from the owner that are claimable against the contractor, unless the contractor specifically has given the subcontractor an assignment of rights against the owner (e.g., a liquidating agreement).⁸ Of those few jurisdictions that generally recognize mechanics' liens, which include various provinces of Canada (including Quebec) and New Zealand, a U.S. contractor will quickly find that its rights under those statutes can be significantly different from those to which it is accustomed.

Analogous lien law statutes to those found in the United States can be found in several of the Canadian common law provinces, such as the province of Newfoundland and Labrador. The Mechanics' Lien Act in this province applies to all contracts, and all subcontracts arising under those contracts, for services or materials used in the making, constructing, erecting, fitting, altering, improving or repairing of land, building, structure or works furnished to an owner, contractor or subcontractor. Like the lien laws in the United States, the lien attaches to the owner's interest in the real property being improved, and the lien is limited to the sum due to the lienor and the sum unpaid by the owner. There also are corresponding deadlines by which the contractor or subcontractor is required to file, serve and enforce its lien.

Quebec, on the other hand, the only code or civil law province in Canada, blends mechanic's lien concepts and the common code-country term: *hypothec*.⁹ A legal hypothec (a security interest arising by operation of law) may arise from the claim of a person taking part in the

Trust fund statutes are as varied and diverse as the mechanics' lien laws that they were designed to complement. Some statutes are merely criminal penal laws and give the contractor no civil right of action against the party that failed to pay it, while other statutes, despite their genesis in the state's penal laws, have been interpreted by courts as permitting civil recourse. Also, some statutes only apply to payments received by the general contractor and not by lower tiers, and some only apply to public projects.

Exemplifying the disparity in these laws are the trust fund laws in New York, New Jersey, Florida and California. New York has likely the most comprehensive set of trust fund laws in the country and they are part of the state's general Lien Law. It applies to all tiers on public and private construction projects, including the owners, and will subject the violator to civil and/or criminal liability. New Jersey's statute,

construction or renovation of an "immovable"¹⁰ to the extent of added value. There is a registration deadline after the end of the work to preserve the legal hypothec, as well as an enforcement deadline. Subcontractor rights exist, if the owner is notified of the subcontract, but the claim is limited to the work, materials or services supplied after such written declaration of the contract to the owner.¹¹

Instead of a "mechanic's lien," New Zealand employs a similar device known as a "charging order". However, pur-

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suant to the Construction Contracts Act of 2002, unlike mechanics' liens in the United States and Canada, which can be applied with no judicial intervention, the charging order is not a prejudicial attachment. Before an owner's property may be encumbered by the claim of an unpaid contractor or subcontractor, there must first be an *adjudication* (an expedited quasi-judicial proceeding akin to an arbitration), to which the property owner is a party. If the adjudicator (arbitrator) renders a determination on the merits that the property owner is liable in whole or in part for the debt, the contractor will be entitled to a charging order against the owner's property, which will be binding

and enforceable against the owner, subject to the owner's right to judicial review.

ing only to moneys paid to general contractors on public improvement projects. Florida's statute, while enacted as part of the state's Construction Lien Law, makes the misapplication of construction funds a criminal offense. After a fast-track hearing, unpaid providers of labor, services or materials are entitled, upon proof, to the following civil remedies against receivers of such funds: an accounting, a temporary injunction and an attachment; the provider, upon proof, is also entitled to such other legal or equitable remedies as may be appropriate. Last, California does not have a specific statute denominating the payment of money on a construction project as trust funds, but courts in that state have viewed them to be trust funds where the parties' contract specifically requires the contractor's receipt of payment to be used for the payment of its subcontractors.

Conclusion

This is just a sampling of the few jurisdictions that have roughly equivalent statutory devices, but as previously stated, mechanics' liens and other analogous concepts do not exist in most jurisdictions. Therefore, without the benefit of a mechanic's lien, when performing work outside of the United States, any device to ensure payment will have to be contractual, requiring the contractor to closely review and negotiate strict payment rights and other protective measures to secure payment, such as parent company guarantees, or letters of credit. ■

¹Because of this Tower of Babel-like diversity seen across the U.S. state statutory landscape, a Model Construction Lien Act was drafted by The National Conference of Commissioners on Uniform State Laws. However, since its finalization in 1987, no state legislature has adopted it.

²In the U.S., state law generally governs property rights, including lien interests. Similarly, the law of the state in which the real property is situated will determine how any mechanics' liens are handled.

³Fairly uniform throughout the various states is the concept that a lien may not attach to public property.

⁴2 U.S.-Mex. L.J. 167, 174.

⁵16-SPG Int'l L. Practicum 11, 12.

⁶Hudson's Building and Engineering Contracts, London, Sweet & Maxwell, 1995, ¶ 11.063, p. 1239.

⁷This article is not intended to be a comprehensive review of the status of mechanic's lien protections worldwide but rather takes a sampling of certain jurisdictions to highlight the need to review specifically payment protection mechanisms.

⁸UAE Civil Code, Article 891.

⁹This term is derived from the term *hypotheca* used in Roman law to denote a pledge or mortgage of property that remains in the possession of the mortgagor or debtor.

¹⁰Defined by statute as "Land and any constructions and works of a permanent nature located thereon and anything forming an integral part thereof," including "plants and minerals, as long as they are not separated or extracted from the land."

¹¹Civil Code of Quebec §2724, et seq. This concept is similar to the requirement for a "preliminary notice" in certain U.S. states.