



GUEST ESSAYS

Pray, Liens And Scream: A/E's Must Use Mechanics Lien Rights Wisely

Eric L. Singer

Wildman, Harrold, Allen & Dixon

2300 Cabot Drive, Suite 455

Lisle, Illinois 60532

(630) 955-0555 (main) | (630) 955-5826 (direct) | (630) 955-0662 (fax)

singer@wildmanharrold.com

Nothing provides clearer warning of a problem than lack of payment on a private project. If the client is not paying you, they lack the funds or the willingness to do so. Either should cause you concern. If the client is unhappy and does not want to pay you, address the problem right away and stop working if you cannot reach an agreement. If you keep working, you will only have a larger receivable to worry about.

If the client lacks the funds to pay you, they will beg or threaten you to finish the work so that financing can be obtained. So you keep working. If the project goes South, you can always sue to get your fees, right?

Recent years have yielded plentiful work for a/e's, few significant payment problems and rare need for litigation to collect fees. Design professionals in practice for more than 8 to 10 years, however, recall the agony of the late-80's and early 90's, when projects went through foreclosure or bankruptcy proceedings and design professionals went hungry. During that period, a/e's learned to watch the Client Barometer, preserve their mechanics lien rights and pursue payment claims when necessary. Tight money and economic turbulence may again make such self-preservation necessary, but watch out for traps and counterclaims for errors and omissions. This article discusses payment claims and liens on private projects. Public projects for municipal, state or federal agencies have different rules that will be left for another day.

Pray For Rain

If someone hires you to perform services, you have a contract (either oral or in writing). If you perform the work and the client refuses to pay, the client has breached the contract and you have the right to sue. If the a/e does sue, the usual response, whether true or not, is an errors or omissions claim. The client will claim that you breached the contract, so they don't have to pay you. The claims range from failure to complete the design (the client stopped paying so you stopped working), over/underdesign (a replacement architect designed it differently), underestimating construction costs (the bids came in higher than the client can afford), failing to provide buildable or permissible plans (the client couldn't make up its mind or tried to build a square peg building on a round hole property), and failing to complete the work in a timely manner (the client's option or financing commitment expired).

You have to report the claim to your professional liability carrier, litigate, attend depositions and court hearings, and, eventually, the court will sort it out or you will settle. Unfortunately, though, you cannot recover your unpaid fees from your own liability carrier. If you committed an error or omission, it may be both a defense to your fee claim, and an independent claim for damages - the worst of both worlds. Your carrier may require that you hire separate counsel to pursue the fee claim at your own expense, while you



GUEST ESSAYS

have appointed defense counsel for the E&O claim. Building a large receivable gives your client more leverage, increases your own legal fees and leaves you with a bigger write off when the error/omission claim is resolved.

Pray for Liens

Even if there is no E&O claim, the client may file for bankruptcy or just lack the resources to satisfy the debt. If so, you would be out of luck without some other way to get paid. In most states, the law provides the right to a mechanics lien for debt incurred in the improvement of private real estate. Used carefully, the lien can force a sale of the property, generating either leverage or cash to pay you.

Real estate holds a special place in American law. Along with due process of law and freedom of speech, the right to own and transfer real property is held among the most important American legal freedoms. The law has developed complex rules governing real estate financing, including the ability to borrow in exchange for execution of a note and mortgage. Construction on real estate is also recognized to provide an improvement to the real estate, for the benefit of its owner. For this reason, the law of nearly every state has developed a mechanism to allow owners to finance development and construction, while balancing the rights of those entitled to be paid for improvement of the real estate.

Mortgages provide a familiar example of a similar procedure. Few people have sufficient funds to pay cash for a house. Most go to the bank to borrow money, sign a promissory note and agree to pay back the loan. The bank advances the money, and secures its right to repayment by recording a mortgage against the real estate. You own the real estate, but the bank physically records or files a mortgage with the local Recorder of Deeds telling the world that it is entitled to be paid. This prevents anyone from buying the house without making certain that the bank is paid first. The mortgage serves as a "lien" or encumbrance on your real estate. If you stop paying the bank, subject to certain notice procedures, the bank can sue to "foreclose" its mortgage, take you to court and have the court sell the house to satisfy the mortgage debt.

Mechanics liens work in much the same way. Anyone providing labor or materials to improve real estate may be entitled to record a document against the real estate. If the debt is proven and the owner cannot pay, the real estate can be sold to pay off the liens. Unlike mortgages, however, mechanics lien foreclosure sales are still relatively rare. There is usually a construction lender or ownership partners with larger stakes in the venture that will refinance, sell or pay off the project short of a sale.

The mechanics lien statutes differ dramatically from state to state, but most provide lien rights to architects, engineers and certain other design professionals (Illinois, for example, extends lien rights to surveyors, property managers and real estate brokers). There is a great deal of variation in a/e lien rights when the project never proceeds. The law has struggled with the nature of improvements to real property, balancing the rights of all involved - whether demolition of an existing building or the provision of landscaping services constitute a lienable "improvement," for example. It is usually necessary to tear down the existing building to construct the new one, and the new one may need extensive landscape work. Demolition without construction seems more doubtful, as does traditional landscape maintenance, mowing, planting and watering. A similar analysis can be applied to plans and specifications used to obtain zoning changes, to support loan applications or to be used in an eventual building, depending on the nature of the final product. Nevertheless, many states explicitly grant lien rights to a/e's even if the project never proceeds. The lien makes it more difficult or expensive (but not impossible) to sell the property or parcels and may give you some leverage to get paid. An owner can "bond over" a lien by providing the title insurer with collateral (a bond, or, in some instances, an unsecured promise called a



personal undertaking). The property can then be sold, but the title insurer is protected to the extent of the bond provided.

Lien Back

A lien is an important right because it provides additional security for your debt. Even if the property owner files for bankruptcy, your lien is enforceable against the real estate as a secured claim. This elevates you out of the world of unsecured creditors who are unlikely to recover anything in a bankruptcy.

Unfortunately, there can be more debt on a piece of real estate than the project is worth. If you have a \$5 Million piece of property with \$7 Million in liens and mortgages, someone gets shorted. This is where the lien laws provide some additional protection. One only needs to spend a day with the kids to hear one of the law's great maxims: I was here first. This is the law of priority - usually first in time is first in right.

Mechanics lien laws tinker with this rule to benefit latecomers who increased the value of the asset. A mortgage lender may provide funds for the project, but the contractors, architects and trades are the ones who turn that \$5 Million dirt into a commercial building with a revenue stream. Under many mechanics lien laws, those who add value will actually jump ahead of a prior mortgage. At the time of sale on that \$5 Million parcel, the first \$5 Million may go to the construction and design team, leaving the lender short. Lenders know this and this is why you may have leverage when you record your lien.

Screams

Lien rights require specific notice and recording procedures peculiar to each state. Any defect in the notice procedures or in the lien document itself can be fatal to the claim, even if unintentional. An overstatement resulting from typographical error has caused dismissal of lien claims in Illinois. Language in previously given waivers of lien also needs to be considered. Remember that you need to be licensed where the project is located to maintain a lien in most states. You also need to know and understand the deadlines imposed by the mechanics lien statute in your state or the state in which the project resides. The American Institute of Architects provides a useful state by state overview in Lien Laws For Design Professionals, May, 1998 (available from AIA or its website, www.aia.org).

As the economy heads for that "soft landing" promised by the economists, don't wait until the last minute to call your lawyer. Owners and lenders need to be identified from county records, title reports need to be ordered and deadlines may pass before you realize that you needed to do something. Keep any eye on accounts receivable and the Client Barometer and find a lawyer that can advise you on professional liability issues as well as your lien rights. A practical lawyer will discuss with you the likelihood of a counterclaim for professional errors or omissions, the effect of your professional liability policy's deductible and the costs of litigation before proceeding. Then you can decide whether to pray, lien or scream.

About the Author: Eric L. Singer is with Wildman, Harrold, Allen & Dixon, Lisle, Illinois. His practice concentrates in construction law and in the representation of design professionals in all aspects of construction claims and dispute resolution.



GUEST ESSAYS

NOTE: This article is intended for general discussion of the subject, and should not be mistaken for legal advice. Readers are cautioned to consult appropriate advisors for advice applicable to their individual circumstances.