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Questionable credit and the case for early mechanics' liens - by Ross Wecker

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In recent years there have been some developments in the Massachusetts mechanics' lien law that have made both lawyers and construction clients question the level of protection afforded by mechanics' liens. More specifically, there have been a number of cases where a general contractor or first tier subcontractor has gone broke during the middle of a project, the lower tiered subcontractors have filed mechanics' liens, and because payment was already made to the contractor that went broke (the contractor typically takes the last payment due and then leaves the project) the liens have been declared invalid. This has made many construction clients question why they should even bother filing a mechanics' lien. If the lien is invalid because it is filed after the customer abandons the project, what is the point of the lien?

A typical factual scenario involves the decision to file a lien after it has already become clear that a higher tiered contractor is experiencing financial difficulty. Imagine a hypothetical situation where a second tier material supplier has completely performed its contract and its customer, a first tier subcontractor, abandons the project after receiving 90% of its contract price, but without paying for the material supplied. This first tier subcontractor simply disappears with the money that is owed to the second tier material supplier.

In such a situation, it becomes critical that the second tier material supplier have filed a notice of identification under the Massachusetts mechanics' lien law early in the project. As will be discussed further below, such a decision should be made early based on the credit worthiness of the customer, not on the fear of ruffling feathers by serving lien documents. The notice of identification, and the notice of contract for a first tier subcontractor, are critical documents because they "trap" the amount of money that is owed between higher tiered contractors at the time they are served and circumvent the "due or to become due" defense that is often used to defeat lower tiered mechanic's liens.

Under the hypothetical presented above, a second tier lien will only "trap" the amount of money that was owed when the notice of identification was served or when the lien was filed. Thus, if the second tier subcontractor waits to file a lien until after the first tier subcontractor has abandoned the project and absconded with 90% of its contract price, the second tier lien will trap almost nothing. Conversely, if the second tier material supplier serves a notice of identification early in the project, preferably before it has furnished anything, it can likely trap its entire contract price in a subsequently filed lien.

This issue begs the question of how and when do you make the decision to serve a notice of identification or file a notice of contract. The simple answer to that question is that it is a decision that should be made as part of any initial credit analysis for a prospective customer. A mechanics' lien is no substitution for the credit worthiness of your customer. It should go without saying that

contractors should not be doing business with customers that have highly questionable credit simply based on the ability to file a mechanics' lien.

Even with mechanics' lien rights, if a customer goes out of business, or can't pay its bills, the contractor or material supplier is likely going to lose money. There is very little profit in most construction jobs and if even one thing goes wrong they can quickly turn unprofitable. Unfortunately, that is the state of construction in our country today. That being said, a construction contractor has to look at mechanics' lien rights as one alternative in a range of options.

On one hand, contractors can choose not to do business with customers that have questionable credit. One would never have to deal a customer going broke, but would also have fewer jobs and less opportunity for profit (no risk, no reward). Another option is do business with questionable customers, but to simply roll the dice by not take advantage of mechanics' lien rights by filing early notices of identification or other liens. Under this scenario one avoids the attorneys' fees and hassles of dealing with the lien, but is completely unprotected in the event the questionable customer disappears with the contract balance. The final option is to assert mechanics' lien rights early and hope for the best. The best result is that the customer doesn't go out of business and pays. The worst result is that there is some measure of recovery even if the customer goes out of business due to the assertion of early mechanic's lien rights. It's not perfect, but it is likely the best option out of the three.

At the end of the day it is important to recognize that a mechanics' lien is part of a belt and suspenders approach. The belt is a good credit decision with respect to your customer and the mechanics' lien is the suspenders. If the belt fails you may end up exposed, but at least you won't end up with your pants around your ankles if you have a good set of suspenders. If you are considering doing business with a customer that has questionable credit, a consultation with a qualified construction attorney should be part of that decision to learn about how interests can be protected by asserting a timely mechanics' lien.

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