

The Homebuyer's Surprise: *Lien Laws Give Subcontractors the Final Word, But Savvy Attorneys Can Protect Clients*

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Many homeowners approach settlement with a mixture of excitement and trepidation arising from the adventure of moving to a new home. For those fortunate enough to be buying a newly built home, they also have the enjoyment of knowing their particular tastes, styles and desires have been incorporated into the construction.

At settlement, the average non-attorney is most likely focused on countertops, windows, cracks, an unseeded lawn and the like, while leaving the title report, home owners' warranty, and other legal matters to their attorney. However, an unforeseen trap in Pennsylvania for such a homebuyer can be easily overlooked: the mechanics' lien rights of subcontractors if the builder doesn't pay its subcontractors.

How can that be, you might ask? At settlement, the deed and keys don't pass from seller to buyer until the remaining purchase price has been paid. Surely, that must extinguish all rights a subcontractor or supplier has to a mechanics lien?

Not in Pennsylvania.

Simply put, the Pennsylvania Mechanics Lien Law, 49 P.S. § 1101 et seq., provides that even if an owner has paid the general contractor in full, if the general contractor does not pay its subcontractors and suppliers, then those subcontractors and suppliers may be able to place mechanics' liens against the property. New homeowners can



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therefore find themselves facing the claims of subcontractors demanding payment — for work for which the homeowner has already paid.

The statutory framework providing for this inequity is clear. The Pennsylvania Mechanics' Lien Law provides in Section 1301 that "every improvement and the estate or title of the owner in the property" is subject to a lien "for the payment of all debts due by the owner to the contractor or by the contractor to any of his subcontractors for labor or materials furnished in the erection or construction, or the alteration or repair of the improvement."

Thus, as counterintuitive as it may sound to the homebuyer, a new home is subject to a lien by a subcontractor as a result of a debt owed by the contractor, regardless of whether or not payment has been made by the owner to the contractor, according to *Fabringer Corp. v. Newman*, noting that payment to contractor does not defeat subcontractor's claim against property.

How can homeowners protect themselves? First, they need to know that the danger of a subcontractor's or supplier's lien is real.

Second, limited protection to a

homebuyer is available since a contractor and/or a subcontractor/supplier may directly waive its rights to a lien for work on a residential building, provided the total contract price is less than \$1 million, "by a written instrument signed by him or by any conduct which operates equitably to stop such contractor from filing a claim," according to 49 P.S. §§ 1401(a)(1) and (2). A subcontractor may also waive lien rights, regardless of the total contract price, provided the contractor has posted a bond ensuring payment to the subcontractor, as stated in 49 P.S. § 1401(a)(2)(ii).

The third means by which a waiver is possible is pursuant to 49 P.S. § 1402, which provides that a contractor's waiver shall be binding against a subcontractor, but the only admissible evidence of such a waiver against a subcontractor shall be:

- Proof of actual notice to the subcontractor before he furnished any labor or materials; or

- Proof that the contract or separate waiver provision was filed in the prothonotary's office and indexed with contractor and owner as both plaintiff and defendant prior to commencement of the work; within ten days after the execution of the principal contract; or not less than ten days prior to the contract between contractor and subcontractor.

In the recent Pennsylvania Superior Court decision *Floors Inc. v. Altig*, a subcontractor with constructive notice of a waiver was bound by that waiver. *Floors Inc.* also held that the 2006 amendments to the Mechanics' Lien

Law do not prevent a contractor from waiving a subcontractor's lien rights.

Thus, under Pennsylvania law, owners can protect themselves from a subcontractor's lien, but the onus is on the owner to negotiate a waiver, confirm a bond is in place, or obtain releases from each subcontractor after payments are made.

It is likely that none of this ever enters most homebuyers' minds. The homebuyer sees only one party across the table — the builder — and not a collection of trades and suppliers. If homebuyers aren't even aware of such a trap, how can they insist that waiver or bond provisions be followed?

That question seems to have driven neighboring states to develop a much more equitable way of dealing with the problem of a defaulting general contractor.

For instance, in New Jersey, the Construction Lien Law provides protection to homeowners against subcontractors provided the general contractor has been paid. In New Jersey, as in Pennsylvania, "[a]ny contractor, subcontractor or supplier who provides work, services, material or equipment pursuant to a contract, shall be entitled to a lien for the value of the work or services performed, or materials or equipment furnished in accordance with the contract and based upon the contract price," according to N.J. Stat. § 2A:44A-3.

However, as a protection to the homeowner, that right is limited by the provisions of sections 44A-9 and 10. Section 9 limits the amount of the claim to the contract price, or any unpaid portion thereof, whichever is less. Section 10 establishes what has been referred to as a "lien fund," which is designed to prevent any party to the contract "double-paying."

Section 10 provides that the maximum amount for which an owner is liable shall not be greater than: "a. In the case

of a lien claim filed by a contractor, the total amount of the contract price between the owner and the contractor less the amount of payments made ... by the owner to the contractor ... or b. In the case of a lien claim filed by a subcontractor or supplier, the amount provided in subsection a. of this section, or the contract price of the contract between the contractor or subcontractor and the subcontractor or supplier, as applicable, ... less the amount of payments made ..., whichever is less."

Thus, if a contractor has been paid in full by the owner, a subcontractor cannot collect from the owner.

As further protection for homeowners, the N.J. Construction Lien Law provides additional requirements for the filing of liens against residential property, including the filing of a notice of unpaid balance, and a mandatory arbitration process prior to the recording of any lien. New Jersey's balancing of the interests of homeowners and subcontractors/suppliers seem to more fairly allocate the risks and burdens of the construction process.

New York law also differs from Pennsylvania in the way it treats the rights of subcontractors against property owners. Article 2 of the Lien Law, NY CLS Lien §§ 3-39, governs the rights of owners, contractors, subcontractors and the like. In New York, a subcontractor's right to a mechanics' lien is in a sense a derivative right. While a subcontractor has a right to a lien separate and apart from that of the general contractor, as stated in *DiVeronica Bros. Inc. v. Basset*, the subcontractor's rights are measured by the contractor's rights under the contract with the owner.

NY CLS § 4(1) provides, in part, "In no case shall the owner be liable to pay by reason of all liens created pursuant to this article a sum greater than the value or agreed price of the labor and materials remaining unpaid, at the time

of filing notices of such liens" Thus, a subcontractor's lien is limited to the amount due under the contract between the owner and general contractor.

Lastly, Delaware, like New Jersey and New York, protects homeowners who provide full payment to their general contractors in good faith. 25 Del. C. § 2707 provides, "No lien shall be obtained under this chapter upon the lands, structure, or both, of any owner which is used solely as a residence of said owner when the owner has made either full or final payment to the contractor, in good faith, with whom he contracted for the construction, erection, building, improvement, alteration or repair thereof."

If payment has not been made in full by the owner, a lien may be obtained by anyone entitled to a lien under § 2702, but the amount of the lien is limited to the amount due to the general contractor under the contract."

Pennsylvania's Legislature may amend the Mechanics' Lien Law to remove this inequity, and perhaps the unfairness of exposing an innocent homebuyer to demands for duplicate payment will be addressed. Until that time, however, homebuyers in Pennsylvania remain in the unenviable position of guaranteeing payment to subcontractors even after full payment to the general contractor has been made. •

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