

MECHANICS' LIENS IN PENNSYLVANIA

INTRODUCTION

For forty years, mechanics' lien issues in Pennsylvania have been adjudicated by reference to the Pennsylvania Mechanics' Lien Law of 1963, 49 P.S. 1101 *et seq.* ("Lien Law") and related statutes discussed below. The Lien Law serves to protect owners of Pennsylvania property and organize the rights of the various involved parties (*e.g.*, general contractors, subcontractors, material suppliers, lenders, etc.) so the outcome of a lien dispute is predictable, thus encouraging stability and commerce.

Given the breadth and complexity of the Lien Law and its related litigation, of course, this article cannot comprehensively examine the area. Indeed, it should be noted that virtually every term used in the Lien Law already has been (or soon will be) subject to withering legal attacks and attempts to define those terms in ways that suit particular litigants (for example, who is and is not a contractor, a subcontractor, what is alteration and how is it different from erection, what is an improvement, when is a structure an "existing" one, and so forth). Credit professionals using such terms, even when informed by experience with projects in other states, should not assume Pennsylvania is like-minded. This article summarizes some essential parts of the Lien Law, and notes some hotly-contested changes to and developments in the Lien Law scheduled to become effective in January 2007.

DISTINCTIVE FEATURES OF LAW IN STATE

The most distinctive and (presently) disputed feature of the Lien Law is probably its provision approving lien waivers, discussed in more detail below. In contrast to several other jurisdictions, notably New York State, the Lien Law makes contractual provisions whereby contractors and subcontractors waive their right to file a lien claim enforceable. New Jersey also passed a 1994 law forbidding enforcement of such waivers as contrary to public policy. Critically, the Lien Law upholds valid waivers even if they were executed before the waiving party was paid. The Lien Law will even find waiver without a contract, so long as there has been ". . . conduct which operates equitably to estop such contractor or subcontractor from filing a claim."

Another somewhat distinctive feature of the Lien Law is its strict statutory nature. Authorities note that mechanics' liens were developed by legislatures not to help contractors but to provide a remedy to small mechanics and tradesman, who were frequently defrauded by owners and contractors in the early days of U.S. development, as the U.S. Supreme Court has stated. With few exceptions, Pennsylvania courts are to strictly construe the Lien Law provisions as written by the legislature, without regard to the common-law principles, *stare decisis*, or "equitable" considerations that often concern courts in matters where the law has developed via litigation. Hence, if you must choose, knowing the statute "cold"

and complying with it step-by-step may be more important than delving into the case law history. It also means that failures by public officials, errors in government record-keeping systems and the like are often no excuse even for arguably blameless parties – if you fail to satisfy a statutory requirement you have no lien claim.

DEADLINE SUMMARY

As a general rule the critical starting date for an analysis is the day you complete work. The Lien Law gives you four (4) months after that date to file a lien claim with the Prothonotary. **This will likely change to six (6) months under the amendments effective January 1, 2007, as discussed below.** But you have time-sensitive obligations in the interim. If you are a subcontractor who performs alterations or repairs, on or before the date you complete work you must give the owner a preliminary written notice that you intend to file a lien claim. **This requirement will likely be eliminated under the amendments effective January 1, 2007, as discussed below.** Further, if you perform alterations, repairs, erection or construction, you must also give the owner another, slightly more detailed written notice thirty (30) days before you file a claim with the Prothonotary.

Note another key set of deadlines – after you file the claim you must serve notice that you filed it upon the owner within one (1) month, and you must file an affidavit or acceptance form indicating that you served the notice within 20 days after you complete the service, lest your claim be stricken. A filed claim is of little value if it cannot be enforced – claimants have two years after the date they file claims to commence suit thereon (this can be extended by written agreement with the owner). Finally, if a claimant does not obtain judgment upon a claim within five years after filing it, the claim is lost – a harsh outcome given litigants' inability to control court dockets, but one arguably consistent with the strict statutory nature of the Lien Law. Enforcement is discussed below.

ENFORCEMENT

The Lien Law provides for the use of the Pennsylvania Rules of Civil Procedure to gain judgment on a lien claim. In other litigation, actions are commenced by filing a complaint or a praecipe seeking a writ of summons, but lien claims can be commenced by filing a complaint or an amicable action agreement.

It seems widely agreed that Lien Law claims are just one remedy available to a litigant; breach of contract actions and other such remedies run concurrently and are cumulative. Indeed, the main purpose of the Lien Law claim appears to be to liquidate a judgment amount (if any) that shall lie *in rem* against the owner's property.

After commencement of suit, the matter proceeds much like other litigation – the allegations of the complaint must be answered or a responsive pleading filed, there are allowed defenses and preliminary objections, discovery is permitted, and trials and appeals therefrom are scheduled and held in the ordinary course, followed by execution procedures.

PRIORITY

Priority rules vary in part depending on whether you are involved in (a) erecting/constructing an improvement or (b) altering/repairing an existing improvement. A claim for erecting or constructing improvements “relates back” to the date when that particular work commenced and was “visible . . . upon the ground”. This is so even if other claims are filed beforehand. Importantly, it does not appear that suppliers get the benefit of this priority rule.

By contrast, claims for alteration or repairs on existing improvements have priority on the date they are filed with the Prothonotary. As noted elsewhere herein, successfully defining these terms (erection, construction, alteration, repair) to fit your fact scenario is key to winning in court.

Finally, it is important to note what appears to be a change in law - under the amendments effective January 1, 2007, mechanics’ lien claims in Pennsylvania will likely be ranked in priority beneath purchase-money mortgages. They will also fall below so-called “open-ended” mortgages, assuming at least some of the money from that mortgage goes to the alteration, repair, erection or construction of the collateral.

BANKRUPTCY

Generally speaking, a party’s interest or position *vis a vis* the debtor and other creditors in a bankruptcy case on the filing date is not determined by reference to any particular provision of the Bankruptcy Code – instead the position is determined by applicable non-bankruptcy law, and very often state laws like the Lien Law. If you are a valid lien claimant under the Lien Law and a secured creditor, you should expect to be treated as such in a bankruptcy case – but be prepared to clearly identify for the bankruptcy court early on the status you seek and the basis for your entitlement to same under non-bankruptcy law. Look out for certain bankruptcy provisions that allow federal courts to “avoid and recover” (a) transfers between the creditor and the debtor in the year - or at least the 90 days - pre-bankruptcy, and (b) any improvements the secured creditor made in its position relative to other creditors during that time frame.

Secured creditors, of course, normally fare much better in bankruptcy court than unsecured creditors, and have a host of defenses and options provided in the Bankruptcy Code that are unavailable to unsecured creditors. For example, the secured creditor’s post-petition filing of a mechanics’ lien generally does not violate the Bankruptcy Code’s automatic stay provision. By

contrast, unsecured creditors who continue taking analogous steps post-petition to collect upon their claims against debtors – without express bankruptcy court approval - are taking legally void actions that will subject them to monetary sanctions. If you are a secured creditor, the debtor has far more obligations to you, less time to meet them, and practically speaking you should be a large focus of the debtor's attention early on in the case, if not even before the case is commenced. While the bankruptcy laws are beyond the scope of this article, it suffices to say that if there is even a fair argument that you are a secured creditor of a party that files bankruptcy, you should consult bankruptcy counsel immediately, file an appearance in the case, and take prompt steps to account for and protect your property and interests. In jurisdictions like Delaware, New York and New Jersey corporate bankruptcy cases can sometimes move at breakneck speed – you will want to ensure that when it comes to your interests, the train has not left the station within the first few weeks.

LIEN WAIVERS

This summer Pennsylvania enacted legislation to amend the Lien Law in certain parts. Apparently the state has come to agree with other states' historical view that allowing contractors and subcontractors to waive lien claim rights is poor public policy and must be strictly controlled – at least before full payment is made. The matter is of particular interest to credit professionals, especially when they are presented with a transaction wherein any party (or the contracts, or the financing structure . . .) relies in whole or in part on a valid lien waiver granted or to be granted. The due diligence required of lenders, investors, and other business associates of owners and developers is likely to increase – it is no longer sufficient (if it ever was) to simply request a copy of lien waiver forms executed by all contractors and subs and “stick them in the file”.

Until now, a particularly brutal (to some) provision of the Lien Law held that if a contractor waived lien claim rights on a project, its subcontractors would also be bound – without their having affirmatively agreed to or signed the waiver – so long as certain minimal notice requirements were satisfied (generally if the sub had actual notice of the waiver before furnishing labor/materials, the contract with the waiver was filed and indexed in advance, and the like).

The rules of the Lien Law “waiver” game change somewhat beginning in January 2007. Smaller (under \$1 million) residential contract projects can still include the waiver much as in the prior law. Subs can also waive lien claim rights if the contractor posts a bond to pay the subs, whether the residential project is small or large. Absent the posting of a contractor's bond, though, generally speaking waivers that subs execute from this point forward must be supported by consideration from the owner – actual payment for the work done – or they will not be enforced by the Pennsylvania courts. Apparently even contractor waivers will be invalid unless given in exchange for actual payment. As before, under the specified circumstances contractor waivers can bind their subcontractors, at least on smaller residential jobs.

RELATED STATUTES

While a multitude of laws are potentially implicated in a mechanics' lien dispute, a few are essential to know. The 1994 Contractor and Subcontractor Payment Act (73 P.S. §§ 501-516) sets forth the basic process for getting paid on a private project and contains important rules about retainage, progress payments and the like. For public projects worth \$50,000.00 or more, the Pennsylvania Procurement Code (62 Pa. C.S.A. § 3901, et seq.) sets forth specific rules with respect to payment due dates, applicable interest rates, penalties, etc. Always worth knowing are the basic provisions of Pennsylvania contract law and, unfortunately, the federal bankruptcy laws. As with most legal matters faced by credit professionals, there is simply no substitute for the contemporaneous advice of counsel with whom you are comfortable.

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