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ENFORCEABILITY OF GENERAL LIEN WAIVERS

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Lien waivers have long been a familiar component of construction projects. Under the usual scenario, a general contractor pays its subcontractor a progress payment and extracts, in return, a waiver of lien rights on the work performed (and paid for) to date. With increasing frequency, however, owners and general contractors are requiring subcontractors and suppliers to waive all lien rights before the contract even begins. This paper will examine the treatment these provisions have received from the courts.

1. A Brief History of Mechanic's Liens.

The lien statutes which protect subcontractors and materialmen did not exist at common law, nor were they creations of equity. They are instead the product of American legislatures, created to prevent the unjust enrichment of owners and contractors at the expense of their suppliers and subcontractors, and no doubt enacted to protect constituents. The first mechanic lien statutes were passed by state legislatures and covered only private projects. Maryland was the first state to pass such a statute, in 1791, and was followed by Pennsylvania and New Jersey in 1820. Every other state in the Union rapidly followed these three.

The stated purpose of these statutes was to encourage the growth of the infrastructure of the new nation by protecting those engaged in building trades. There was a large hole in the safety net, however. For the first century of this country's history, suppliers and subcontractors on public projects simply took their chance on being paid. The government, whether state or federal, was protected by sovereign immunity; its property was exempt from seizure and could not be liened.¹ The federal government required a bond from general contractors, but this was a performance bond only. Under the prevailing legal climate of the day, subcontractors and suppliers were left to fend for themselves.²

Congress finally remedied this in 1894, with the passage of the Heard Act.³ The Heard Act provided for a single bond to guaranty both payment and performance obligations.⁴ This caused initial problems as the government found itself competing with suppliers and subcontractors under the bond and, after some flawed attempts at amendment,⁵ Congress

¹ See, e.g., United States ex rel. Hill v. American Surety Co., 200 U.S. 197, 202, 26 S. Ct. 168, 50 L. Ed. 437 (1906).

² United States Fidelity & Guaranty Co. v. United States, 191 U.S. 416, 424, 24 S. Ct. 142, 48 L. Ed. 242 (1903).

³ Chapter 280, 28 Stat. 278 (1894).

⁴ United States Fidelity & Guaranty Co. v. United States, 191 U.S. at 425.

⁵ Congress first addressed the problem by simply amending the Heard Act in 1905 to specify that the rights of the U.S. under the bond were superior to those of unpaid claimants. Chapter 778, 33 Stat. 811 (1905).

repealed the Heard Act and replaced it in 1935 with the Miller Act.⁶ During this same period, from 1890 through 1930, virtually every state legislature passed a similar statute.

It was the growth of these little Miller Acts which spurred the development of the commercial bonding industry. Prior to 1890, only personal sureties were accepted or available. It appears that the growing demand for sureties outstripped the supply of willing, well-heeled human beings, and the corporate surety for hire was born. According to one source, Fidelity and Deposit Company was the first commercial surety to convince the federal government to accept corporate surety bonds, although in its infancy some of its bonds had to be guaranteed by its shareholders.⁷ In due course, however, corporate sureties became the norm rather than the exception, largely as a result of the demand created by lien statutes.

2. General Lien Waivers.

One might think that the very reasons mandating the creation of a statutory right to a mechanic's lien might militate against any effort to require the waiver of that statutory right by contract. Indeed, the very imbalance in bargaining power which led legislatures to enact these statutes would seem to indicate that leaving this issue to contractual regulation might not work very well. However, if one thought any of these things, one would be dreadfully wrong.

Courts have shown no reluctance whatsoever to enforce statutory lien waivers. Jurisprudence supports the conclusion that general lien waivers executed prior to contract performance are completely enforceable. As a general rule, a clear and unambiguous provision in a contract whereby a contractor waives his rights to a mechanic's lien or agrees not to file a lien is valid and binding and will preclude the contractor from asserting a right to a lien. See, e.g., J. B. Cieri Const. Co. v. Gramercy Const. Corp., 13 A.D.2d 901, 215 N.Y.S.2d 994 (App. Div. 1961); Bendik v. Uniontown S.R. Co., 408 Pa. 66, 182 A.2d 512 (1962); Hammond Hotel & Improvement Co. v. Williams, 95 Ind. App. 506, 176 N.E. 154 177 (1931); Mitchell v. Wrightstown Community Apartments, Inc., 4 N.J. Super. 321, 67 A.2d 203 (App. Div. 1949); Capitol Plumbing & Heating Supply Co. v. Snyder, 104 Ill. App. 2d 431, 244 N.E.2d 856 (1969).

For example, the subcontract at issue in S.J. Groves & Sons Co. v. Midwest Steel Erection Co., Inc., 666 F. Supp. 129 (N.D. Ill. 1986), contained a broadly worded lien waiver. It provided that:

The Subcontractor agrees that it shall not at any time file any lien, or stop notice to a government agency, or notice of claim to a lien of any kind or nature whatsoever, nor permit the same to be filed for work performed or materials furnished pursuant to the terms of this Agreement or any

⁶ 40 U.S.C. §270 et seq.

⁷ John B. Hayes, "Protection of a Surety's Interests On A Construction Project," p.7, fn. 12. Paper presented at the Mid-Winter Meeting of the Forum on the Construction Industry, January 25, 1990.

modification hereof, or for an extra work performed or materials furnished or for any other reason or upon any ground whatsoever; and, Subcontractor does hereby waive and relinquish the right to any and all liens, stop notices, or claim of liens [sic.] as may be permitted or provided for by any provisions of law.

Id. at 130. The subcontractor argued first that the waiver was against public policy because the underlying project was a public project. The court cited to several Illinois cases for the proposition that waivers of mechanic's liens by subcontractors are upheld in Illinois. Id. at 131. It then stated that it had no reason to conclude that public policy required a different result because the project involved was public. Id. The subcontractor also argued that the waiver provision was ambiguous, but the court disagreed, concluding that the language was "clear and sweeping." Id.

Likewise, in Fuller Co. v. Brown Minneapolis Tank & Fabricating Co., 678 F. Supp. 506, 512 (E.D. Pa. 1987), the court determined that a lien waiver clause was not against public policy in either Pennsylvania or Minnesota. There is no discussion of the lien statutes and their purpose in the decision; instead, the arguments concerning public policy were brushed aside almost without comment.

As public policy arguments were not swaying courts, claimants who had waived their rights predictably began to advance the improbable argument that a general lien waiver could not possibly be enforced if the would-be lien claimant had not been paid. The courts quickly administered a mercy killing to this argument: for example, the court in Hammond Hotel & Improvement Co. v. Williams, 176 N.E. 154 (Ind. App. 1931), wondered how one could waive lien rights if paid in full, as the rights only come into existence when not paid. The argument was also rejected in Mitchell v. Wrightstown Community Apartments, 67 A.2d 203 (N.J. 1949).

More recently, in Richardson Engineering Co. v. International Business Machines Corp., 554 F. Supp. 467 (D. Verm. 1981), aff'd, 697 F.2d 296 (2d Cir. 1982), the federal district court enforced a lien waiver that stated:

Subcontractor, for itself and for all persons furnishing labor, materials or services in connection with the Work, waives and releases all mechanic's liens or right of liens or claims, now existing or hereafter arising for labor or materials furnished under this Subcontract, upon the Project or Project premises or upon any monies due or to become due the Contractor.

Id. at 471. The court enforced the waiver despite the subcontractor's argument that -- because the general contractor breached the general contract -- it was not entitled to the benefit of the lien waiver. The court concluded that the validity of the waiver was unaffected by the alleged breach of contract:

Surely, in waiving its statutory right to a lien on defendant's property, plaintiff contemplated a contractual breach by defendant . . . ; were there no breach, the lien would likely never come into play.

554 F. Supp. at 471. See also Beacon Construction Co. v. Matco Electric Co., Inc., 521 F.2d 392 (2d Cir. 1975) (applying New York law); Bushman Const. Co. v. Air Force Academy Housing, Inc., 327 F.2d 481 (10th Cir. 1964) (applying Colorado law); Charles Simkin & Sons, Inc. v. Massiah, 289 F.2d 26 (applying New Jersey law); Formigli Corp. v. Fox, 348 F. Supp. 629 (E.D. Pa. 1972) (applying Pennsylvania law).

In Wardlaw Bros. Garage, Inc. v. Thomas, 140 So. 108 (La. 1932), and in Babineaux v. Grisafi, 180 So. 2d 888 (La. App. 3d Cir. 1965), the courts found that mechanic's liens had been waived by implication. The Supreme Court in Wardlaw stated broadly, "Liens may be lost in a number of ways [including] by waiver expressly agreed to, or by waiver arising by implication from the facts and circumstances of the particular case." 140 So. 2d at 109.

In Executive Office Centers, Inc. v. Courmoyer, 433 So. 2d 324 (La. App. 4th Cir. 1983), the defendant, a lessee, had renovated the building that it leased from plaintiff. Plaintiff argued that defendant had violated a provision in their lease that prohibited defendant from entering into a contract in excess of \$15,000 whereby a lien or other encumbrance could be recorded against the property.⁸ The court concluded that defendant had not breached the lease because he had produced "evidence of documents, all contracts, which expressly waived any right to lien the property." Id. at 327. The court stated that Louisiana jurisprudence recognizes the validity of such waivers, quoting the Louisiana Supreme Court's broad language in Wardlaw and citing to Babineaux.

In Toomer v. Price, 122 So. 856 (La. 1929), the Louisiana Supreme Court upheld the validity of another lien waiver agreement between a subcontractor and a surety. As an inducement to the surety company to furnish a bond to the general contractor, a subcontracting lumber company agreed that it would not record a lien for the lumber to be furnished, which amounted to about half of the contract price. Id. at 857. Despite the agreement, the lumber company filed a lien when the general contractor defaulted. The Louisiana Supreme Court concluded that given the agreement, the lumber company's only recourse was against the general contractor. Id. at 857-58. It interpreted the agreement to mean that if the general contractor should default on his contract, the surety would not be liable for the lumber. Id. at 857.

Hero & Co. v. Farnsworth & Chambers Co., Inc., 107 So. 2d 650 (La. 1958), also involved an agreement to waive lien rights. In that case, defendant was the prime contractor for the construction of a building. Loup & Younger was the lowest bidder for the plumbing and heating work. Unable to furnish the performance bond required by defendant, Loup & Younger presented defendant with an alternate arrangement. Plaintiff, Loup & Younger's supplier, agreed to furnish the materials required by the subcontract and to waive its lien rights if defendant made all checks due under the subcontract payable jointly to plaintiff and Loup & Younger. Defendant agreed to the arrangement and made some payments in accordance with the agreement. However, defendant ultimately withheld funds. Plaintiff filed a lien despite the waiver and brought suit against defendant and Loup & Younger.

⁸ Although Louisiana's Private Works Act was not mentioned expressly, presumably this would be the source of the lien rights.

The Louisiana Supreme Court concluded that plaintiff gave up all of its lien rights against defendant, its surety, and the owner, in exchange for preferential payment over all others from the money that would come into the hands of Loup & Younger. 107 So. 2d at 654. It determined that because plaintiff had been given control of enough money to pay its claim, it could not recover from defendant, its surety, or the owner, and should look to Loup & Younger for payment. *Id.* at 656. One Justice wrote a lengthy dissent, disagreeing with the majority's failure to recognize the validity of plaintiff's lien. He reasoned that because defendant had not fulfilled its obligation of making all checks on the job payable to plaintiff and Loup & Younger, defendant was not entitled to the benefit of the lien waiver as to the monies that it had not paid. *Id.* at 657 (Tate, J., dissenting).

3. Statutes Governing Lien Waivers.

Some states deal with lien waivers by statute, either prohibiting them entirely or specifically allowing them. In such cases, the courts follow the statutes – unless, of course, they can deftly sidestep them. For example, in General Growth Development Corp. v. A&P Steel, Inc., 678 F. Supp. 243, 245 (D. Colo. 1988), the Colorado court quoted a statute that stated: "No agreement to waive, abandon or refrain from enforcing any lien provided for by this article shall be binding except as between the parties to such contract. The provisions of this article shall receive a liberal construction in all cases." *Id.* at 245 (quoting C.R.S. § 38-22-119). In that case, the court concluded that a general provision for the "subordination of all rights under this contract" did not amount to an express waiver of rights to a mechanic's lien. *Id.* at 245.

In Aetna Casualty & Surety Co. v. United States, 655 F.2d 1047 (Ct. Cl. 1981), the Court of Claims was faced with the following contractual provision:

The Contractor shall file no mechanic's or materialman's lien or claim against the Owner's real estate or improvements for or on account of any work done, labor performed or materials furnished under this Contract.

655 F.2d at 1057. This had to be interpreted in light of a California statute providing that

the [lien] rights and obligations of parties to contracts . . . are subordinate to the intention of the parties . . . and the benefit thereof may be waived by any party entitled thereto, unless such waiver would be against public policy.

655 F.2d at 1058 (quoting Cal. Civ. Code § 3268 (West 1974)).

The court was thus faced with the issue of whether the waiver was against public policy. Reviewing national authority, the court found that the majority of jurisdictions allow such waivers. The court further considered California Civil Code § 3262 (West 1974), which invalidated provisions purporting to waive the lien rights of third parties, and found the implication of that statute to be that a person could waive his own rights.

The Second Circuit Court of Appeals relied on a New York statute regarding lien waivers in Beacon Construction Co., Inc. v. Matco Electric Co., Inc., 521 F.2d 392 (2d Cir. 1975). It quoted Section 34 of New York's Lien law as stating that a subcontractor may not forego or waive his right to a lien "except by an express agreement in writing specifically to that effect, signed by him or his agent." Id. at 395. It concluded that the waiver at issue complied with that statutory requirement. The waiver provided:

The Subcontractor hereby agrees that no mechanic's or other lien . . . shall be filed . . . by it against the building and improvements . . . for or on account of any work done or materials furnished under the Subcontract . . . and that the filing of any lien . . . shall be grounds for termination of this Subcontract The Subcontractor hereby formally and irrevocably releases and waives any and every mechanic's, materialman's and any and every other lien . . . that it has or may at any time be entitled to have against the aforementioned buildings, improvements and real estate, together with its right to file any and every such lien.

Id. at 394.

There is at least one reported federal decision in which a court determined that a lien waiver was against public policy based on an express statutory provision. In Southeastern Savings & Loan Ass'n. v. Rentenback Constructors, Inc., 114 B.R. 441 (E.D.N.C. 1989), aff'd, 907 F.2d 1139 (4th Cir. 1990), the federal district court cited to a North Carolina statute providing that:

An agreement to waive the right to file or claim a lien granted under this article, which agreement is in anticipation of and in consideration for the awarding of any contract, either express or implied, for the making of an improvement upon real property under this Article is against public policy and is unenforceable.

Id. at 445, n.5 (quoting N.C. Gen Stat. 44A-12(f)). Unfortunately, the case did not include any discussion of the reasoning behind the statute or of other authorities.

4. **Waiver of Third Parties' Lien Rights.**

In some cases, courts have gone so far as to hold that a lien waiver provision in a general contract operates as a waiver of a subcontractor's lien, at least when the subcontractor has notice of the waiver provision in the general contract. The general rule applied here is that such a waiver will be enforced against third parties if: 1) it is clear from its language that it is intended to embrace the liens of subcontractors and materialmen; 2) such a waiver is not prohibited by the jurisdiction in question; and 3) whether there has been compliance with any statutes concerning the issue. See Annotation, General Contractor's Waiver of Lien, 75 A.L.R.3d 505, 517 (1977).

The cases involving this issue are very fact-driven, and the analysis often seems result-oriented. Relevant cases include In re Hull, 19 B.R. 501 (N.D. Ind. 1982); Pero Building Co. v. Smith, 504 A.2d 524 (Conn. App. 1986); Luczak Brothers, Inc. v. Generes, 451 N.E. 2d 1267 (Ill. App. 1983); Torres v. Meyer Paving Company, 423 N.E. 2d 692 (Ind. App. 1981); Mace v. Bryant Construction Co., 269 S.E.2d 191 (N.C. App. 1980).

5. Conclusion.

In the absence of statutory provisions invalidating them, general lien waivers are enforceable. In those jurisdictions where the filing of a lien is a condition precedent to instituting suit against the surety, these waivers can provide a devastating defense against claims.⁹ However, while a claims attorney or outside counsel can make good use of this weapon and should do so, some thought should be given by management to whether this trend is a good development for the industry as a whole. The corporate surety came into being at the turn of the century in large part in response to the demand for protection against mechanics' liens. If an owner can protect itself from these liens without the surety, why pay a bond premium?

⁹ In Louisiana, for example, the surety would remain liable to first tier claimants. La. R.S. 9:4812 addresses the obligations of a surety on a private project, and provides that:

C. The condition of the bond shall be that the surety guarantees:

(1) To the owner and to all persons having a claim against the contractor, or to whom the contractor is conventionally liable for work done under the contract, the payment of their claims or of all amounts owed them arising out of the work performed under the contract . . . for which it is given.

(Emphasis added.) This clause clearly gives subcontractors a direct action against the contractor's surety regardless of whether a lien is filed, and the courts have so held. Reilly Bros., Inc. v. Dicon, Inc., 354 So. 2d 651 (La. App. 1st Cir. 1977); Harris Paint Co. v. Quinn Const. Co., Inc., 282 So. 2d 543 (La. App. 4th Cir. 1973).