



Waiver of Lien Forms - It's Not That Simple

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Project owners routinely require contractors to execute waiver of lien forms before issuing periodic and/or final payments. Be forewarned, however, executing such a waiver before actually receiving all payments due can become a major obstacle to a general contractor's and/or its subcontractors' ability to ultimately be fully paid for their work.

It happens every day. A contractor certifies in a waiver of lien that it has been paid in full for the work covered by the monthly pay application. The owner pays the contractor; the contractor pays its subcontractor. All is well. But maybe not. The issue is what happens in the event that a subsequent payment dispute arises between the owner and the contractor or between the contractor and its subcontractors. Can the executed lien waiver be used to defeat a subsequent claim by the contractor and/or its subcontractors? The answer, unfortunately, is "yes."

In a recent case, a general contractor executed a "Affidavit & Waiver of Lien" in which the general contractor acknowledged receipt of all sums due from the owner for the period covered by the monthly pay requisition. Thereafter, a subcontractor filed a mechanic's lien against the project, alleging that it was not, in fact, paid in full for labor and materials supplied to the project.

The subcontractor commenced a foreclosure action to enforce its mechanic's lien placed against the private project. The owner moved to dismiss the lien claim, arguing that it had already paid the general contractor in full, and that full payment was evidenced

by the general contractor's execution of the Affidavit and Waiver of Lien. The owner presented additional documents, including cancelled checks and wire transfers to show that all monies requisitioned by the general contractor had been paid. The subcontractor/lienor argued that, notwithstanding the statements in the Affidavit and Waiver of Lien, money remained due from the owner, and that the Affidavit and Waiver of Lien had been obtained through "fraud."

Frankly, a fraud allegation in that context was a weak and desperate legal argument. In reality, the problem was the general contractor's negligent execution of the lien waiver. To make a short story even shorter, the court wasted no time dismissing the subcontractor's fraud claim and ruled in favor of the owner, dismissing the subcontractor's lien foreclosure action.

The court held that mechanic's lien rights are "derivative." In other words, as explained by the court:

[t]he principle is well settled that the rights of a subcontractor are derivative of the rights of the general contractor and a subcontractor's lien must be satisfied out of funds due and owing from the owner to the general contractor at the time the lien is filed.

Because the general contractor executed a waiver of lien stating that it had been paid in full, the court ruled that no monies were due from the owner to the general contractor for the subcontractor's claims. It did not matter that payment disputes existed between the general contractor and its subcontractor.

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Because the general contractor executed a statement declaring that it had been fully paid, that was the end of the story with respect to the owner's potential payment obligation.

The Court's wholesale reliance upon the executed Affidavit and Waiver of Lien for its finding is troublesome for several reasons. It is common practice in the industry to execute a lien waiver prior to actually being paid. In fact, there appears to be a widely-held assumption by contractors that a lien waiver is "conditioned" upon subsequent receipt of the funds. This assumption, however, is incorrect.

Section 34 of the Lien Law codifies public policy regarding waiver of liens in New York. The law does not permit any agreement to undermine or waive statutory lien law rights except for one exception. According to Section 34, a written waiver of mechanic's lien rights, executed and delivered by a contractor, subcontractor, material supplier or laborer simultaneously with or after payment to the lienor is enforceable. In practice, however, the affidavit and lien waivers are not exchanged simultaneously with or after payment. They are typically executed prior to payment as part of the normal, monthly requisition submittal package.

A second serious concern relates to critical subcontractor lien rights. When a general contractor acknowledges payment from the owner by executing a lien waiver, it is, in effect, also waiving all its subcontractors' lien rights. Unless the subcontractor can recover from the general contractor, there will likely be no recovery. Due to the general contractor's execution of the lien waiver, the subcontractor is left without lien rights against the property (on a private project) or the public construction fund balances (on a public job). Because the lien rights by the subcontractor are derivative to those of the general contractor, execution of the waiver by the general contractor may also be deemed to waive its subcontractor's lien rights.

G& C Commentary

A general contractor reckless or desperate enough to execute an "overstated" waiver of lien acknowledging payments not yet made will prematurely give up its own lien rights, and quite possibly, lose its right to collect the monies acknowledged as paid, but not yet actually received.

The general contractor also exposes itself to becoming the so-called "bologna in the sandwich" in disputes between its subcontractor and the owner. Where either the owner, in bad faith, fails to subsequently issue payment, or, more typically, subcontractors assert valid claims for additional or extra work, the general contractor becomes squeezed between its exposure to the subcontractors for extra payment and its inability to collect additional monies from the owner. Subcontractors, in turn, while perhaps still technically able to file mechanics' liens, are without a real remedy because they will not be able to "catch" any funds owed to the general contractor by the owner. No funds are "owed" because the general contractor prematurely admitted payment in full by the owner in its lien waiver.

This case should remind us that the defense of "that's the way it's always been done" rarely works and is unlikely to convince a court that a lien waiver does not mean precisely what it states, namely, that full payment has already been made. The caveat is to be extra cautious when executing lien waivers and to fully understand the implications of the statements contained in the waivers.

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