

THE CONSTRUCTION LAW BULLETIN

October 2006

Amended Mechanics' Lien Law Gives More Rights to Contractors and Subcontractors.

If you are a contractor or subcontractor in Pennsylvania, you no doubt are familiar with the law known as the Mechanics' Lien Law of 1963. You may have used this law to protect your right to receive payment for your work. But most likely, your recent experience with this law has been owners' increasing demands that contractors agree to waive their right to file a mechanics' lien. These lien waiver agreements also eliminated the subcontractors' right to seek the protection of a mechanics' lien. That is all about to change.

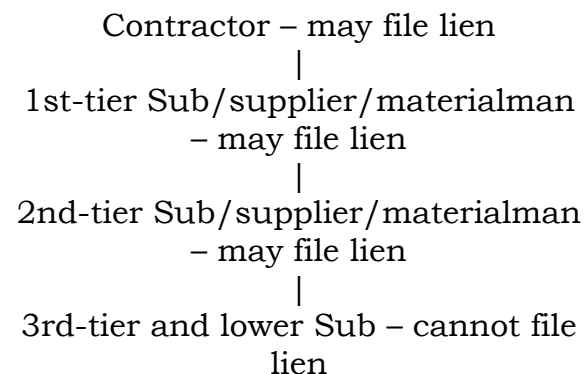
On June 29, 2006, Governor Rendell signed House Bill No. 1637 into law. The amendments take effect on January 1, 2007. Under these amendments, the Mechanics Lien Law of 1963 will for the first

time provide protection not only to contractors and subcontractors, but to sub-subcontractors as well. And the new amendments not only restrict the types of projects on which owners may demand lien waivers, but also provide greater protections when such waivers are permitted.

Sub-Subcontractors Are Now Protected.

The Mechanics' Lien Law under its current form provides protection to contractors and first-tier subcontractors only. The amendments extend the law's protection to second-tier subcontractors, or sub-subcontractors. Persons who can now file a mechanics' lien include contractors, subcontractors, sub-subcontractors and suppliers or materialmen who either have a contract with a contractor or who have a contract with a subcontractor who has a contract with the prime contractor.

The following diagram shows the changes:



Enforceability of Lien Waiver Agreements Limited.

Under Section 401 of the current law, contractors were able to waive their lien rights simply by signing a lien waiver agreement with the owner. This has been changed.

For residential construction, a contractor or subcontractor (including first and second-tier subs) may only waive the right to file a lien where the total contract price between the owner and contractor is less than one million dollars (\$1,000,000). Subcontractors may waive their lien rights irrespective of the price of the owner-contractor contract on residential construction projects where the contractor has provided a payment bond guaranteeing payment for labor and materials provided by subcontractors.

For projects involving non-residential buildings, lien waiver agreements are unenforceable except to the extent that the contractor or subcontractor has received actual payment for the work, services, material or equipment provided. Again, where the contractor has provided a payment bond, the subcontractors' lien rights can be waived without the restrictions stated above.

The practical effect of these amendments is that contractors may only waive their lien rights on residential projects where the contract with the owner is less than one million dollars, but may not waive their lien rights on non-residential projects, regardless of

the amount of the contract with the owner. Subcontractors may waive their lien rights on any project where the contractor has provided a payment bond and on residential projects under one million dollars. On non-residential projects, a subcontractor's lien waiver will only be enforceable up to the amount that the subcontractor has actually been paid on the project. This will amount to what are commonly known as "partial lien waivers" as the project proceeds.

When determining whether you are dealing with a residential project, the contractor or subcontractor should be careful to read the amendment's definition of "residential building" in Section 201, as this definition is rather broad. The definition includes property on which there is a residential building, which is zoned or approved for residential development, planned development or agricultural use, or for which a residential subdivision plan or planned residential development plan has received preliminary, tentative or final approval.

Changes to Time Limitations and Notice Requirements.

Under current law, subcontractors who wished to file a mechanics' lien for work related to alterations and repairs had to provide "preliminary" written notice to the owner of its intent to file a lien on or before the last day that work was performed. The obvious problem with this requirement was that the subcontractor often would not know

of the need to file a lien until after the work was completed and payment was not made. The amendments remove this preliminary notice requirement.

The law still requires a subcontractor to provide the owner with formal written notice of its intent to file a mechanics' lien at least thirty days before actually filing the lien, whether it is for alterations and repairs or erection and construction.

Current law requires all claimants to file the mechanics' lien within four months of the date that work was last performed. The amendments extend the time for filing a lien to six months.

Priority of Liens.

The last change made by the recent amendments relates to the priority of mechanics' liens. The addition of Section 508(C) makes all mechanics' liens subordinate to both purchase money mortgages and open-end mortgages. For situations involving open-end mortgages, mechanics' liens are subordinate only where the mortgage proceeds are used to pay all or part of the cost of completing erection, construction, alteration or repair of the mortgaged premises secured by the open-end mortgage.

In all other situations, mechanics' liens continue to enjoy priority as they did prior to the amendments.

These amendments will impact every party involved in construction, including owners, contractors, subcontractors, sub-subcontractors and lending

institutions. The amendments will apply to contracts entered into after January 1, 2007, at which time all of the changes to the law become effective. It will be important to take the changes discussed above into consideration when moving forward with projects once these changes are in effect.

Where there is uncertainty as to the effect of the amendments or your rights under the new law, owners, contractors and subcontractors should consult with the appropriate professionals in the construction, legal or financial lending industries.

THE CONSTRUCTION LAW BULLETIN is produced to inform and not to advise. While this periodical is based on existing law, the statements herein are general, and the status of the law is subject to change. Individual facts in a given case may alter the procedural necessities or substantive issues involved in prosecuting or defending a claim. Should you have an issue that you believe is similar to any of those discussed herein, we urge you to consult an experienced construction attorney.

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