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Subordinate Lienors Must Explore All Options For Payment

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The recent economic downturn has taught the construction industry many important and often difficult lessons. One such lesson is the relative value of a construction lien that is inferior to a foreclosing lender. When a lender forecloses, the unpaid construction professional, who at one time held a valuable security interest (construction lien) in the improved property, is left with few attractive alternatives. It can sue the party with which it was privy for breach of contract, but if that party is insolvent, it will, as the proverbial saying goes, throw good money after bad. In some cases, the only party which retains anything of value with respect to the project is the lender. A subordinate lienor has limited rights with respect to the foreclosing lender, but in some instances, options are available.

Equitable Liens

The contractor, subcontractor or supplier may be able to impose and foreclose an equitable lien in order to secure payment. Depending on the circumstance, equitable liens may be imposed upon undisbursed

(Subordinate Lienors Must Explore All Options For Payment - Continued from page 1)

construction loan funds retained by the lender, or over the lender's mortgage interest on the real property.

In many jurisdictions, an unpaid lienor can impose an equitable lien upon undisbursed construction loan proceeds. The underpinning theory is that a mortgagee which forecloses and takes possession of the security for the note will be unjustly enriched if it is also able to retain the remaining, undisbursed construction loan proceeds.

In some states, Florida, Pennsylvania, Minnesota and North Carolina for example, the project must be complete in order to impose an equitable lien upon undisbursed construction loan proceeds. This requirement is based on the supposition that if the project is not complete, the lender would need to utilize the undisbursed funds to complete the project.

However, in other jurisdictions, like Arizona, a construction lender and contractor can agree that the lender is entitled to undisbursed construction loan proceeds which are not available to third parties, such as unpaid subcontractors and suppliers. In that case, an

Some courts, including in California and Florida, allow the imposition of an equitable lien superior to the lender's mortgage interest. This remedy is available when the lender has committed some fraud or misrepresentation, such as misrepresenting that the loan is not in default. Florida courts refer to the misrepresentation as creating "special and peculiar equities" which give rise to a claim of equitable estoppel. Simply put, it would be inequitable to allow a lender to benefit from its misconduct.

Statutory non-compliance

Lienor's whose interests are being foreclosed may also be entitled to relief from the lender if it failed to comply with certain statutory requirements.

In Florida for instance, Florida Statutes §713.3471 requires a construction lender to advise the general contractor, and any lienor which has given the lender notice, that it intends to stop disbursing money pursuant to the terms of the loan. If the lender fails to give the requisite notice, it may be liable to the contractor who continued performing based upon the expectation of continued payment from the lender. The lender's liability is based upon the actual value of the materials or services provided after it gave notice, plus fifteen percent

In other jurisdictions, such as California, lienors can serve the lender with a "stop notice" when payment is overdue. The stop notice demands that the lender withholds money from its disbursement of the loan to pay the lienor. A lender who has received a stop notice, accompanied by an appropriate bond, must withhold the sum claimed owed. If it disburses without holding back the money, it may be personally liable to the lienor to the extent of the stop notice.

Conclusion

A lienor whose lien is subordinate to a foreclosing lender should explore all options available to it in pursuit of payment. The party with which it contracted is often the cause, or a fellow casualty of the financial difficulties leading to non-payment. In those cases, the conduct (or misconduct) of the lender should be scrutinized to determine if it has an obligation to pay .

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