BY SCOTT G. WOLFE

IS EVERYTHING YOU KNOW ABOUT *Lien Waivers Wrong?*

The lien waiver is an unassuming document that is constantly exchanged among parties in the construction industry. This document is usually prepared, signed, and passed along without much fanfare or analysis. But the laws and cases that affect lien waivers depend on a variety of factors that can be as broad as the project's state and as nuanced as its specific characteristics.

Since lien waivers are exchanged so routinely, their details are often overlooked in favor of practical needs. This has created confusion as to how these waivers should actually work.

In fact, there are two critical reasons CFMs need to understand lien waivers. First, they are intrinsically tied to getting paid, and getting accounts receivables paid quickly is an important part of the CFM's job. In fact, it's been suggested that accounts receivable is the single most impactful component to a contractor's cash management.[1] And second, as guardians of a company's financial risk and exposure, CFMs must exercise careful concern to avoid over-reaching or inaccurate lien waivers.

This article will discuss what can be known about lien waivers, common industry misconceptions, and what CFMs can do to better manage these documents for their companies.

What Can Be Known About Lien Waivers

Lien waivers are nuanced documents that are dependent upon many variables built into both the law and the jobsite. This makes it difficult to know anything definitive about lien waivers. However, here are a couple of universal truths about these documents.

Universal Truth #1: It's Difficult to Waive Lien Rights Before Payment Is Exchanged

Numerous laws exist to protect against the possibility that a contractor or supplier might waive their lien or bond claim

rights before actually receiving payment. These laws fall into three categories and are subject to only a few exceptions.

First, "no lien clause" laws completely prohibit a party from waiving its rights within a contract or before doing the work of a contract. In other words, it's legally impossible to agree to forfeit lien rights.[2] Contract provisions that give up lien rights are voided by these statutes, which underscore strong U.S. public policy to protect contractors and suppliers against nonpayment.

In some cases, the laws prohibiting these types of waivers are very strict. Consider Tennessee Code Annotated (TCA) § 66-11-124(b), which provides that "if a contractor solicits any person to sign a contract requiring the person to waive a right of lien…[after a hearing] the contractor's license shall be immediately revoked." Similarly in Illinois, 770 ILCS 60/21.01 makes such behavior by a contractor a criminal misdemeanor.

There are only three statutory exceptions to the "no lien clause" rule (Virginia, Colorado, and Nebraska), but even in these states – and other states where the rules are more ambiguous – no lien clauses are upheld only when they are drafted perfectly. (See Exhibit 1.)

Second, every state allows parties to sign and exchange conditional lien waivers. Simply defined, the waiver is ineffective until payment exchanges hands, which then renders the waiver effective and unassailable. Property owners, lenders, and GCs typically want lien waivers in-hand from lower-tier parties before issuing a payment. This tool allows contractors and suppliers a clear way to give waivers without fear of nonpayment.

Third, whenever a lien waiver is signed, regardless of what the document may say, many state laws consider it a "conditional waiver" by rule until payment is actually made. For example, in California, lien waiver behavior is strictly contained based on the actual payments exchanged between the parties (as opposed to the lien waiver's specific language).[3] Similar laws exist in Mississippi,[4] Texas,[5] and several other states. Most states with regulated lien waiver forms will also regulate the ability to exchange unconditional waiver forms when payment has not yet been exchanged.

Universal Truth #2: A National Standard Lien Waiver Form Does Not Exist

Although there is not a national standard lien waiver form, 12 states have "regulated" waiver forms. (See Exhibit 2.) It is mandatory that parties doing construction in these states use the standard forms – regardless of where parties are from or where their companies are headquartered.

When nonstandard waivers are exchanged in these 12 regulated states, the consequences are severe and tend to benefit the signing contractors and suppliers. Many states impose penalties against parties that request another party to sign a lien waiver that does not conform with the standardized waiver.[6] In addition, any nonstandard waiver is typically void, which leaves the parties without any waiver at all.

Exhibit 1: **No Lien Clause Restrictions**

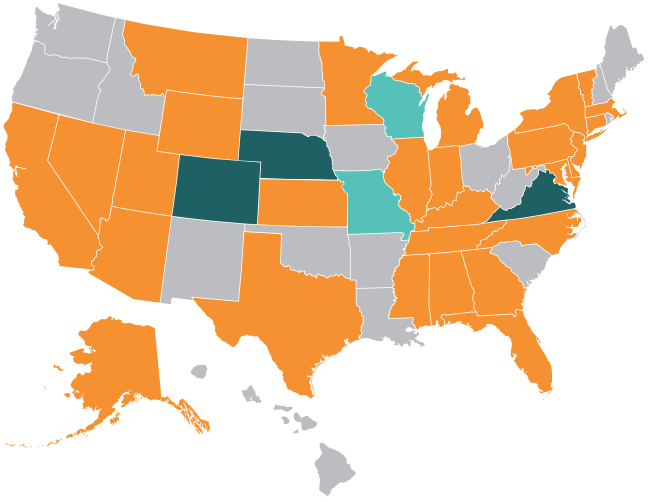
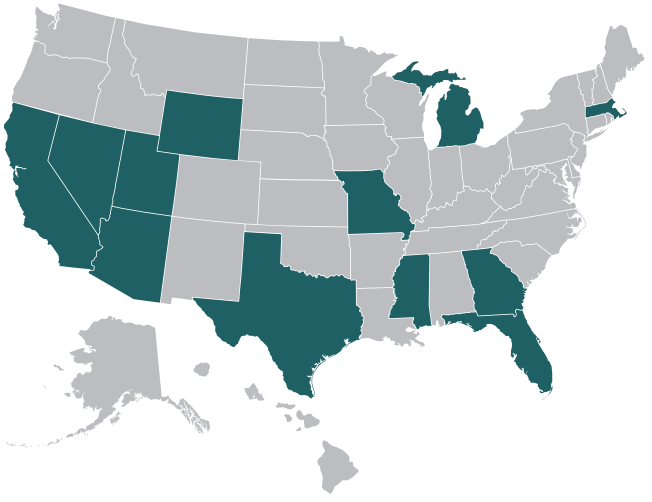


Exhibit 2: **Regulated Waiver Forms**



In response to payment abuses and waiver issues, there is also a trend toward certain states standardizing their own lien waiver process. In just the past three years, the number of states with standardized lien waiver forms jumped from nine to 12, as California, Texas, and Mississippi implemented standardized lien waiver processes during this period.

The results have been positive overall, but challenges persist even in states with statutory forms and regulated processes. Since there is no national standard, parties must account for nuanced differences particular to the state regulations as they cross over state lines.

Industry Misconceptions

Unfortunately, industry participants often incorrectly assume these universal truths are standard practices within their company or region; however, it is far more likely that these practices don't conform to the nuances of any specific project, and do not travel well.

More importantly, the lien waiver exchange process is too often viewed as a leveraged negotiation or tense, distrustful exchange of risk. This is completely at odds with the waiver's purpose as a benign acknowledgement of payment.

These two misconceptions guide the next discussion of how the industry frequently goes awry with lien waiver practices.

Diversion #1: Lien Waiver Terms

Whether lien waiver terms are regulated or unregulated, the waiver is presented to subcontractors and suppliers for signature at a very vulnerable time (when payment is anticipated) and the reward (cash) for a signature is great. This timing, combined with document confusion, leads to problems with the waiver's language. The trend toward regulating lien waiver language intends to offset this vulnerability and the parties that take advantage of the same.

First, many GCs, lenders, sureties, or developers will mandate the use of a single waiver form on all projects, without considering the state's particular laws. For example, a contractor that performs a lot of work in New York may have a few projects in New Jersey, but since it is so familiar with New York's waiver rules, it may expect compliance with those rules instead of learning New Jersey's nuances. This typically results in lien waiver terms that are illegal, void, illogical, or carry unexpected consequences.

Second, these same parties may take advantage of the situation to include favorable language in lien waiver forms. It is common to see provisions waiving rights to make claims for change orders, extra work, disputed items, retainage, and other contractual rights. Even more common, parties will demand an "unconditional" type of waiver before payment is made. Though these waivers are voided in some states, other states will hold a signor's feet to the fire.

Examples of Legal Implications of **Lien Waivers**

In ***The Laquila Group, Inc. v. Hunt Construction,*** a subcontractor sued a GC for payment, and the GC defended itself by producing a lien waiver electronically exchanged through a waiver technology platform. However, the New York court invalidated the lien waiver despite very broad language, and stated that waivers "will not be read as applying to claims the parties did not intend to waive."

Interestingly, the court pointed to the method of the exchange (i.e., through electronic platform): "the circumstances surrounding the execution of these documents reveal an issue… regarding whether the documents constituted mere receipts for payment actually received."

The lesson from this case is that courts may go out of their way to prevent contractors and suppliers from waiving rights they didn't intend to waive. In other words, inserting overreaching language into a lien waiver may be more trouble than it's worth.

The opposite of this decision was reached in the Minnesota case, ***J.H. Larson Electrical Company v. C&S Electric, LLC et al.*** There, it was clear that a subcontractor signed a lien waiver indicating that it received money it did not in fact receive.

The cost of lien waiver arguments can be substantial, as seen in the turbulant Texas case of ***Port of Houston Authority of Harris County, Texas v. Zachry Construction Corporation***. This case concerned about $20 million in change orders and liquidated damages. The owner argued that Zachry Construction waived all defenses to a liquidated damages assessment (i.e., $20 million) when it signed a broad lien waiver. The appeals court agreed with the owner, costing the contractor $20 million in liquidated damages and $10 million in attorney fees. This decision was reversed by the Texas Supreme Court and the parties were left to determine just how much was owed irrespective of the lien waiver. Notwithstanding the eventual outcome, the lesson here is that waiver interpretations can take a long time, carry significant legal expense, and be quite unpredictable.

Third, since specialty subcontractors and suppliers receive high volumes of unique waiver requests, and the terms can be nuanced and complicated, it's difficult to adequately analyze all of them. They frequently sign things they shouldn't (even in spite of policies to the contrary) due to the volume of requests received and the incentive of receiving payment when they sign.

Diversion #2: The Phantom Catch-22

Getting paid on a construction project can seem like a Catch-22. The paying party, wanting to mitigate its lien exposure before handing out cash, needs a lien waiver before exchanging payment. However, the receiving party, fearful of potential payment issues, needs to receive payment before providing a waiver.

How can parties reconcile these competing needs? Must the parties exchange the documents at the same time, use an escrowing service, or invest in technology to make a simultaneous handoff? The truth is that the Catch-22 does not exist. This false fear is based on a misunderstanding of how lien rights and lien waivers actually work.

Conditional lien waivers are available in every state for every type of project. These waivers protect the paying party because they are effective and binding immediately upon payment, and they protect the receiving party because they are ineffective until the payment is exchanged.

There is no legal reason for either party to not accept a conditional lien waiver, and using conditional lien waivers resolves the Catch-22 false fear as well as the needs of both the receiving and paying parties.

How CFMs Can Manage & Improve the Lien Waiver Process

Managing lien waivers fairly and in a company's best interests is quite complicated. The laws can be unclear and too numerous to master, the volume of requests can be too high to police, and the many personalities behind the requests can cause CFMs to waver between the specific request form's fidelity to correctness and the practical need of preserving industry relationships and getting cash.

So, what can CFMs do to improve the process?

#1: Commit to Waiver Text Parameters

Whether a top-tier or lower-tier party, an organization should be certain about what it will and will not agree to within a lien waiver document.

Contractors should create a library of acceptable waiver forms or provisions (including the 12 states with regulated lien waiver forms) and avoid agreeing to any other variations without full legal review.

Contractors that receive waiver requests while waiting for payment must develop the discipline to say no when waiver provisions are not within the parameters. Sometimes this may require negotiation at the start of a project, as many contracts already contain the mandatory waiver form.

#2: Fight Against the Fictional Catch-22

The concern about needing a lien waiver before making payment, or vice versa, is a false one. CFMs should educate themselves on conditional lien waivers and stop fearing the false waiver Catch-22.

#3: Think About All Tiers

All parties down the contracting chain must be considered when collecting or producing lien waivers, or requiring a certain lien waiver form.

The first-tier subcontractors are the most likely to be contractually committed to using a certain waiver form and process, but everyone below them – especially suppliers – may not be. These companies will all have their own procedures, personalities, and biases.

Collecting waivers from the tiers may be easier said than done, but can be made remarkably easier through a commitment to payment fairness when exchanging lien waivers.

Conclusion

Lien waivers are constantly passed back and forth on construction projects. Since they are exchanged so frequently and usually without much incident, the documents are often overlooked.

Nevertheless, lien waiver documents are risky, convoluted, and vastly misunderstood by industry participants. CFMs can lower their companies' risk exposure and improve their processes by being informed about common misconceptions, and more importantly, by committing their company to fairness in waiver exchanges. ■

Endnotes

1. "Cash and Liquidity Management," *CFO Magazine*, July 17, 2012. *www.cfo.com/research/index.cfm/displayresearch/14650160.*
2. It is a very uncommon, but existing, occurrence for some GCs to demand their subcontractors not send a preliminary notice. They enforce this demand by refusing to continue to work with the subcontractor if a preliminary notice is sent. The effect of this demand is to require the subcontractor to forfeit their lien rights. This practice is not specifically addressed in any "no lien clause" statutes, but considering the purpose of the statute, it is easy to imagine a court disciplining such practices by allowing lien rights despite a failure to send preliminary notices, or to otherwise ding the GC with a finding of fraud.
3. When a party is "not, in fact, paid in exchange for a waiver," then California Code § 8132 invalidates all lien waiver forms that are not conditional upon receipt of payment. Further, if a payment has been actually received by the party, then California Code § 8134 invalidates all lien waiver forms that are not unconditional. In the vast majority of cases in California, therefore, it is impossible for a party without money actually in hand to waive their lien rights through a lien waiver exchange.
4. Mississippi Construction Lien Law Code Ann. § 85-7-419(5)(b)(iii) provides that all waivers are revocable if payment is not made within 60 days of waiver execution, but the party must actually file a document to revoke the waiver.
5. Texas Property Code § 53.283, making illegal for any person to require an unconditional waiver be executed "unless the [signing party] received payment in that amount in good and sufficient funds."
6. Consider the case in Tennessee (TCA § 66-11-124(b)) and Illinois (770 ILCS 60/21.01).

SCOTT G. WOLFE is CEO of *zlien* in New Orleans, LA, a platform that reduces credit risk and default receivable for contractors and suppliers by giving them control over mechanics lien and bond claim compliance.

A CFMA member and prior author for *CFMA Building Profits,* he also contributes to *Construction Executive* Risk Management eNewsletter, *MultiBriefs*, Funding Gates Blog, *Construction Finance Journal*, and *Credit Today* "Outside the Box" column.

He earned a BA in History and Political Science from Southern Methodist University and JD from Loyola University New Orleans College of Law.

Phone: 866-720-5436, ext. 700
E-Mail: scott@zlien.com
Twitter Handle: @scottwolfejr