Mechanics' liens and public improvements: A primer

November 4, 2022

Mechanics' liens on public construction projects are a fact of life. Although they may seem familiar, it does not pay to regard them too casually. Mechanics' liens are statutory creatures, and anyone dealing with them needs to follow the statutory procedure precisely to avoid undesirable consequences. Liens differ depending on the type of project—private construction, public construction, home improvement work, railroad work and several other categories. Do not assume that one size fits all. This article provides some of the basic information necessary to avoid disaster in dealing with mechanics' liens for public construction projects.

What Is a lien?

Liens are the statutory remedy that a subcontractor, material supplier, or materialman will use to protect payment due for work or materials provided to a project. (To simplify the discussion, when this article refers to "subcontractor," it will mean subcontractor, material supplier or materialman.) By properly following the public lien process, a subcontractor may recover money that is "due and unpaid" to a principal contractor before that money reaches the hands of the principal contractor. Thus, in the public context, the lien is only against the funds owed to the principal contractor, not against the property itself. So, no lien claimant can insist that public property be sold in order to assure the subcontractor gets the money owed for its work on the project.

A public owner, lien claimant and principal contractor face many pitfalls throughout the statutory process of asserting and administering lien claims. From the beginning of the project to a certain point after the work ends for a subcontractor, there are many important events and time periods that must be watched closely by a potential lien claimant. Owners and contractors also have important events and time periods, and must follow the lien statutes to protect their own rights.

The notice of commencement

Before any work is started or any materials are furnished for a construction project, the public owner must prepare a notice of commencement. Unlike on private construction projects, the notice does not need to be filed with the county recorder or posted on the job site for a public improvement project. The purpose of the notice is to provide subcontractors and suppliers with information about the owner that they may need later if they have to submit an affidavit for unpaid funds to the owner.

Ohio Revised Code § 1311.252 lists the things that must be included in a notice of commencement.

- Name, location, and number used by the public authority to identify the improvement;
- Name and address of the public authority;
- Name, address, and trade of all principal contractors;
- Date the public authority first executed a contract with the principal contractor;
- Name and address of the surety for each principal contractors; and
- Name and address of the representative of the public authority upon whom service shall be made.

If the notice is not prepared or is otherwise not available to contractors before work begins, the public authority faces no statutory penalty. But it risks missing out on receiving some important information it may need later.

The notice of furnishing

To protect their lien rights, subcontractors who do not have a contract with the principal contractor need to serve a notice of furnishing to the principal contractor. The term "serve" is defined by statute. R.C. § 1311.19 states that "any notice, affidavit, or other document" served under Chapter 1311 of the Ohio Revised Code must be provided in one of three specific ways:

1. Service by the sheriff of the county in which the person to be served resides. This is done in one of the methods provided in the Ohio Rules of Civil Procedure;
2. Service by any method that includes written evidence of receipt. Some of the methods that could be used include certified or registered mail, overnight delivery service, and hand delivery; or
3. If the "person" is a corporation, then there is a special means of service provided in R.C. § 1701.07(H) that must be used.

Let's assume that a subcontractor sends its notice of furnishing to the principal contractor by regular mail. Let's also assume it is received by the principal contractor, but there is no record of the date of receipt. The subcontractor has failed to preserve its lien rights unless it can prove that the principal contractor acknowledged receipt or the subcontractor can prove by a preponderance of evidence that the principal contractor actually received the notice. This can be a daunting task that is unnecessary if service is made using one of the above methods.

Timing is everything where the notice of furnishing is concerned. It must be served on the principal contractor within 21 days after the subcontractor first performs work on the project. If the notice is not served within this 21-day period, the subcontractor will lose any lien rights for the work or materials provided more than 21 days before the notice is served. If a subcontractor eventually serves its notice of furnishing, its rights will be preserved for only the 21 days prior to the proper service of the notice of furnishing. Many a procrastinating subcontractor has learned a lesson the hard way by losing a significant amount of money due to the improper or late service of a notice of furnishing.

The statute on notices of furnishing also requires principal contractors and subcontractors to provide to any subcontractors or suppliers with whom they contract both their own name and address and the name and address of the public authority. That way, the lower tier subcontractors will have the information they need for the notice of furnishing. If the principal contractor and

subcontractors fail to provide this information, they may be sued by any affected subcontractors or suppliers, who may recover damages that resulted from any loss of their lien rights because they lacked this necessary information.

The heart of the matter: An affidavit of claim for unpaid funds

If a subcontractor has submitted its applications for payment in a timely manner, it should be paid within 10 calendar days of the owner's payment to the contractor for their work or material. This rule comes from Ohio's Prompt Payment Act. But, suppose the owner paid the principal contractor more than 10 days ago, and the subcontractor is still waiting for its money. The unpaid subcontractor may establish a mechanics' lien on the remaining funds due to the contractor by serving the affidavit described in R.C. § 1311.26 on the public authority that owns the project. Again, timing is everything. The affidavit must be served to the representative of the public authority named in the notice of commencement within 120 days from the last date the subcontractor performed labor under the contract or the supplier furnished materials for the project.

There isn't any wiggle room in the 120-day period. When dealing with mechanics' liens, it is crucial that all statutory deadlines be met. In most cases, when the last work is completed, the time begins to run for filing a mechanics' lien. Miss the deadline, and the lien is not valid.

Properly filing a lien is especially important when determining any priority the lien may have with respect to other creditors. To see what happens when the statute is not followed precisely, we look to a case that dealt with a private project and an owner's failure to pay for construction work on that project. In *Swim Rite Pool Company v. Strausbaugh*, 6th Dist. Sandusky No. S-05-026, 2006 WL 1943325 (July 14, 2006), a pool contractor working on a home construction and renovation project let his lien rights float away by failing to file the lien within the statutory time period. The pool contractor completed installation of the pool in October 2002, but apparently was not fully paid.

The homeowners filed for bankruptcy in April of 2003. Although the pool contractor was still waiting to be paid in full, he had not yet filed a lien. More than 60 days—the statutory period for filing a lien on a residential project—had passed since he completed the installation.

The contract for the installation of the pool did not include a solar cover or solar reel, which were optional accessories. They had been discussed and rejected, but the homeowners decided later that they did want these additions. In May of 2003, the pool contractor returned to deliver and install the solar cover and solar reel in the pool.

On June 25, 2003, the pool contractor filed a lien for the unpaid amounts related to the work to install the pool. The court said this lien was invalid, citing the 60-day statutory period for filing a lien for work related to a residential project. The contractor argued that the lien was filed within 60 days of the installation of the solar cover and solar reel. But the court held that these were a separate contract from the pool installation. If the contractor wanted to protect his rights on the pool installation, he had to file a lien in December, 60 days after the installation was complete.

Serving a lien claim within 120-days of the last work performed or material provided on a public construction project is not the only consideration given by subcontractors. Subcontractors often quickly serve a lien claim when there is a sign that the principal contractor is in trouble and/or the project is nearing an end. This is because there is a small window of time a lien claimant has to submit a lien claim to trigger the owner's obligation to withhold contract funds. Since a public owner is only required to withhold contract funds that are due and owing to the principal contractor, the lien claim must be served upon the public owner before the principal contractor submits an application for payment or before the public owner makes payment to the principal contractor.

In *L.E. Myers v. Jordano Electric Company*, 47 Ohio App. 3d 132, 547 N.E.2d 1014 (10th Dist. 1988), Jordano received periodic payments from ODOT. Jordano, however, failed to pay L.E. Myers for work that it performed. ODOT terminated Jordano and owed Jordano no more money when it was notified of Myers' first lien. The appellate court held that a subcontractor is not entitled to recover on its lien when the owner has paid the principal contractor everything owed to the principal contractor. If Myers had served the lien before all the funds were paid to Jordano, then funds due and owing to Jordano may have been

withheld. Serving the lien claim within the 120-day period was not enough to protect Myers because, by the time Myers served its lien, there were no funds due and owing to Jordano—the contract funds had essentially been reduced to zero. Jordano also stands for the proposition that a public owner has priority to funds due and owing to the principal contractor when the contract between the public owner and the principal contractor permit the public owner to decertify, nullify, or otherwise recover contract funds from the principal contractor.

What information must the affidavit of lien claim contain to be valid? The lien affidavit should contain, at a minimum, the following information:

1. Amount due and unpaid for the labor and work performed and material furnished;
2. When the last labor was performed or material furnished, with all credits and set-offs; and
3. The post-office address of the lien claimant.

Also note that the affidavit must be "served" upon the representative of the public authority named in the Notice of Commencement. The same service requirements discussed above apply here.

The lien claimant must also file the lien with the County Recorder within 30 days of service of the affidavit of claim upon the public authority, according to R.C. § 1311.29. Failure to properly record the affidavit of claim doesn't waive any rights the subcontractor may have against the party owing it money, but it does put the lien claimant in a much worse position with respect to other lien claimants that have properly recorded their claims against the same party.

Recording the claim sets up a lien claimant's priority as to other claimants. If a lien claimant records its lien, it and other lien claimants who recorded lien claims with the county recorder will have priority over lien claimants who have not recorded their lien claims. Lien claimants that fail to record their lien claim with the county recorder will receive a pro-rata share of the money left over—if any—after all of the lien claimants who properly recorded their claims have been paid.

The public authority's obligations

Once the public authority receives the lien affidavit, R.C. § 1311.28 requires that the public owner detain funds from the balance of the funds remaining under the contract with the principal contractor that are owed to the principal contractor. The amount of funds detained for the lien claimant cannot exceed the amount of the claim that was made, nor can it exceed the amount of money remaining under the contract with the principal contractor. The public authority must keep the funds in an escrow account in accordance with Ohio law.

If the lien claimant was required to submit a notice of furnishing—in other words, if the claimant is a subcontractor that did not contract directly with the principal contractor—then it must provide a copy of the notice to the public authority and a sworn statement as to the date the notice was served upon the principal contractor. If such a lien claimant fails to do this, then the public owner cannot retain any funds.

If a public owner fails to detain the funds and goes ahead and pays the principal contractor, it may ultimately have to pay the lien claimant as well. In this situation, the public owner would pay twice for its mistake. As the court in *Richards v. Bennett*, 3 Ohio App. 240, 21 Ohio C.C.(N.S.) 554 (1st Dist.1914), said 98 years ago, "[a]n owner who fails to retain in his hands a sufficient amount to satisfy the claim of a material man, who has given proper notice, becomes liable on such claim notwithstanding the payments which he made after notice [was] made in good faith."

Once the owner receives the lien affidavit, it must also serve the principal contractor with a copy of the affidavit, even if the lien claimant has already done so. Service must occur within five days of the owner's receipt of the lien affidavit.

The notice provided to the principal contractor must state that it has 20 days to dispute the lien. If the contractor fails to dispute the lien within 20 days, then it has assented to the correctness of the lien.

The public authority, a principal contractor, or a subcontractor that receives a lien affidavit may serve a notice to commence suit upon the lien claimant, under R.C. § 1311.311. This notice means the lien claimant must file a lawsuit to enforce its lien within 60 days or its lien will be void, and the funds can be released to the principal contractor. Such a notice speeds up the process and allows the parties to use the courts to determine the validity of the lien or the amount due to the respective lien claimants, or to resolve any other issues. Failing to file a lawsuit within 60 days after receiving such a notice does not mean the subcontractor must stop trying to collect the money it is owed, but it will no longer have the security of a lien as protection.

If the contractor does dispute the lien, it may want to have the funds released from escrow while the dispute is being worked out. Posting a bond pursuant to R.C. § 1311.311 and issuing a notice to commence suit, will void the lien claim and permit the release of contract funds to the principal contractor. The bond must equal 150 percent of the amount of the lien, be in favor of the lien claimant, and be provided to the public owner, who must approve the form of the bond. Subcontractors or other interested parties may also post such bonds.

When should the funds be released?

According to R.C. § 1311.28, funds placed in escrow may not be released unless one of three things has happened:

1. The public authority is ordered to release them by the court;
2. The public authority is requested to release them by the principal contractor and the lien claimant because those two parties have come to an agreement; or
3. The lien claimant fails to commence suit (if a notice to commence suit was given under R.C. § 1311.311).

Of course, the public authority would also release the funds in escrow if a bond had been posted, as discussed above.

As the Ohio Supreme Court explained in *State ex rel. Dinneen Excavating Co. v. Sykes,* 40 Ohio St. 3d 84, 1313, 531 N.E.2d 1309 (1988),

> When funds due subcontractors have been placed in escrow pursuant to R.C. 1311.28, a court of competent jurisdiction must order the release of the escrow funds to specific parties, in specific pro-rata amounts, and at specific times, as properly determined by that court unless the parties agree to the amount owed. Where the parties agree to the amounts owed, the owner must distribute the funds on a pro-rata basis according to R.C. 1311.31.

The bottom line

Working with liens can be a tricky endeavor. The statutes impose deadlines, require language that must be included in certain notices and other documents, dictate escrow accounts, and mandate service and other requirements. The process discussed above is just the tip of the iceberg, as there are many intricacies to each part of the lien process for public construction projects. Whether you are dealing with a lien on a public improvement project or a lien on some other type of work, it is a good idea to consult with an attorney who is experienced in that area of lien law.

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