

# *Bonding Off Liens*

*By: Kristin Alford*

## **Abstract**

*A Surety Bond Claim occurs when the principal on a surety bond does not fulfill their obligations agreed to within the bond language, and the surety bond obligee claims the principal has defaulted on the surety bond.*

## **Around, Off & Over: Discharge Bonds and Mechanic's Liens**

For those that secure mechanic's lien rights, there are a few events that may scare them a bit. For example, some fear they will upset their customer and jeopardize future business relationships, while others fear the costs and complications of extensive title work (solar and wind farms), and of course there is the fear of a potentially arduous and expensive process of having to enforce their lien.

The truth is, yes, you may upset your customer if you have to file a lien and later enforce it – but you are only doing this because they haven't paid you – do you really want to do business with companies that don't pay you? And yes, the costs and complications with projects like solar and wind farms can be steep and time consuming, but often your contract is high for these types of projects, making elevated lien costs justifiable.

But one fear that lien claimants should not have is Bond-Off-O-Phobia. It's a real thing – OK, the name isn't real, but the fear of a mechanic's lien being bonded off is alive and well. I intend to assuage that fear, because contrary to popular belief, the bonding off of a lien is not the end of the world – it's security.

## **Instant History – Liens & Claims 101**

Before we jump to the bonding off of liens, let's take a quick look at some basic concepts. As you know, every state has its own set of laws governing mechanic's liens and bond claims.

*What is a Mechanic's Lien? "A security interest that may be acquired in property by someone who spends material or labor working on that property. A mechanic's lien usually stays in effect until the lien holder gets paid for services provided. The failure to pay for services as agreed may allow the lien holder to keep possession of the property involved. A mechanic's lien is not necessarily limited to mechanics. To prevent confusion, other names may be used for the same concept (e.g., construction lien,*

*laborer's lien, artisan's lien, supplier's lien, garageman's lien, materialman's lien, and design professional's lien).* – Legal Information Institute (LII)

In the simplest of terms, a mechanic's lien is a lien against real property by one providing materials or services to the project.

What is a Bond Claim? “A *Surety Bond Claim* occurs when the principal on a surety bond does not fulfill their obligations agreed to within the bond language, and the surety bond obligee claims the principal has defaulted on the surety bond.” – Alpha Surety & Insurance Brokerage

Again, simply put, a bond claim is written notice informing the prime contractor or surety that the claimant, e.g., subcontractor, supplier, or materialman, looks to them for payment.

In the event a mechanic's lien is filed, there is an opportunity for the lien to be removed from the property with the filing of a discharge bond (*aka* transfer bond). The primary difference between a discharge bond and the more familiar payment bond, is that the payment bond is for the benefit of any/all parties furnishing to a project, whereas the discharge bond is specific to the lien it is bonding off.

### **It's a Security-Swap**

Discharge bonds may be used in lieu of a mechanic's lien? Yes! The process of a bond “replacing” a lien is sometimes referred to as bonding *around* a lien, bonding *off* a lien or bonding *over* a lien.

Let's imagine that one of those inflatable dancing tube people is the mechanic's lien. The inflatable dancing tube guy has to be attached to something or he will blow away. In this case he is attached to the building and the only way to remove him from the building is to give him something else to attach to. So, the GC obtains a discharge bond and the dancing tube guy dances himself away from the building and attaches himself to the discharge bond, which is weighted down with the backing of a surety. The dancing tube guy is still secured - but now he is secured by the weight of a surety instead of the frame of the building.

### **Do All States Permit Bonding Off?**

Yes, actually. As of 2016, every state officially provides for the bonding off of a lien, though each state has its own guidelines and requirements for the bonding off (i.e. the required amount of the bond).

Illinois was the last state to join the ranks when it enacted statute in 2015 to allow the bonding off of liens. For more information on Illinois statute, I encourage you to read “Bonding Over in Illinois – New Law Allows for Lien Release with Surety Bond” by attorney James T. Rohlfing.

## It's Prevention or Discharge

There are two types of bonds to get around liens: **prevention & discharge**.

1. **Prevention:** bonds that prevent a lien from attaching to the property  
Example: Florida statute provides for the prevention of a mechanic's lien filing. If a bond is properly recorded, any lien filed would actually attach to the bond instead of the property.
2. **Discharge:** bonds that remove a lien that is already attached to the property  
Example: Illinois statute provides for the removal of a mechanic's lien filing. A bond can be substituted for the lien, essentially changing the collateral from the property to the bond.

## They Can Just Eliminate My Lien?!

In short, no. The bonding off of a lien does not eliminate your rights, it changes your rights. Instead of pursuing the claim against the property, you would pursue the claim against the bond.

*"This is bad, right - Changing the method of security for the materials or labor I provided to the improvement of the project?"* Don't think of this security change (from lien to bond) necessarily as bad, think of it as different.

*"But, the contractor threatened to bond off my lien!"* It's not a threat – well, I suppose technically it's a "threat" because the contractor is trying to intimidate you. Threats indicate something awful will happen and the bonding off of a lien is not awful! Most often, the clout of encumbering the owner's property is enough to prompt payment. When the lien is bonded off, the immediacy of that clout is lost, but the security is still there.

Let me say it again, **you still have security**. The security is different and the rules for maintaining that security may be different, but you typically have security to the same extent that you had security under the lien.

## Who Benefits from the Bonding Off of a Lien?

Perhaps the better question is, who doesn't benefit? To which I would answer, the surety, because now they are faced with paying your claim and the principal of the bond (frequently the general contractor) because they are now in hot water with the surety.

Ultimately the property owner(s) and the claimant(s) benefit from the bonding off of a lien. Once a discharge bond has been substituted for the mechanic's lien, the owner's property is no longer encumbered by the lien and the claimant is set to seek payment from the surety.

This is a bold statement, but for a claimant, **bonds can be better than liens**. Here's an example: Let's say you file a mechanic's lien, but the owner cannot pay you because the owner has no funds. If you file suit to enforce your lien, and the owner's equity in their property is not sufficient to cover your claim, you lose. However, if the lien was bonded off, you would instead look to the surety for payment, in addition to the principal of the bond. Sureties are typically

well funded, and if your claim is valid, it would likely result in payment. Statute requires the threshold of the bonds to be a certain percentage of the claim amount of the lien filed, typically 100% to 175% of the lien amount.

### **You're Telling Me There Are No Downfalls to Bonded Off Liens?**

No, I'm not saying that bonded off liens are "downfall free". One downfall to a lien being bonded off is that if the interested party (owner, general contractor, etc.) is going to the expense to obtain a bond, the chances are good that they do not plan to make payment anytime soon. Or, a lien may be bonded off because the lien amount is disputed.

Another issue is that some states don't require the lien claimants be notified of a bond being substituted for the property. This means if the GC antes up a discharge bond, the GC doesn't always have to notify claimants that the bond exists.

Fortunately, when liens are transferred from encumbering property to attaching to a bond, claimants do not typically need to make any additional claims – their claim transfers with the change in security. Unfortunately, there may be circumstances where the deadline to enforce a claim under a bond is different from the deadline to enforce a mechanic's lien, and if the deadline is missed, the claim could be invalidated.

### **The Deadlines Can Change?**

It's quite possible the suit deadlines may change if a lien is replaced with a bond.

In Texas, if a lien is bonded off, the deadline for suit to enforce the claim varies, depending upon when the bond was recorded:

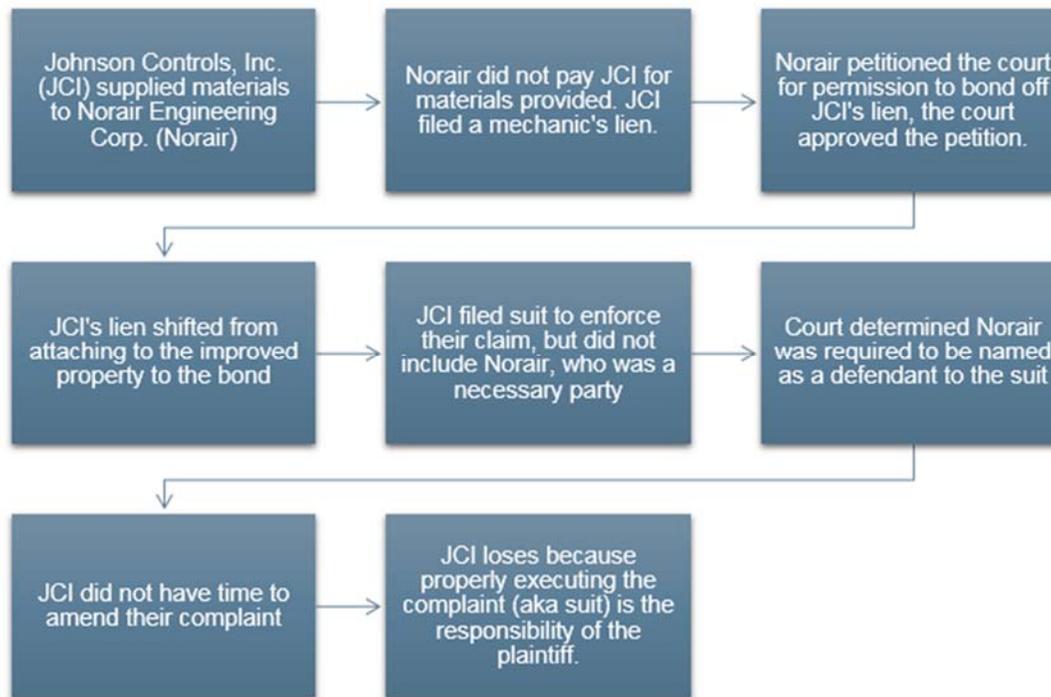
*Sec. 53.208. ACTION ON BOND. (a) A claimant may sue the principal and surety on the bond... (d) If the bond is recorded at the time the lien is filed, the claimant must sue on the bond within one year following perfection of his claim. If the bond is not recorded at the time the lien is filed, the claimant must sue on the bond within two years following perfection of his claim.*

In states like New Jersey, when a lien is bonded off, the deadlines associated with suit to enforce the claim do not change. Whether a claimant is enforcing a lien or a bond claim, the enforcement time is within 1 year from last furnishing materials or services.

### **The Swap of a Lien for a Bond Could Change the Rules – Case in Point**

As mentioned above, if the security changes, the deadlines to enforce your claim may change too. But it's not just the deadlines that should concern you; including the correct parties in the suit (enforcement) process is also imperative.

**The Case:** Johnson Controls, Inc. v. Norair Engineering Corp., et al.  
Here's a look at the highlights in a flow chart -



Ultimately, JCI sought to enforce their claim, but failed to name Norair as a defendant in the suit. Because they were not named as a defendant to the suit, Norair was not able to defend the perfection of the lien. Subsequently, the court determined that JCI's enforcement was invalid, and unfortunately JCI ran out of time and was unable to amend or refile their complaint.

### **Cash is King**

Selling on open unsecured credit in the construction industry can be dangerous, and obtaining timely payment, or payment at all, may seem impossible. Mechanic's lien and bond claim rights are vital to promoting prompt payment within the construction industry and should be in the credit management arsenal of every construction credit professional. Being a secured creditor reduces DSO and bad debt write offs, while improving cash flow and working capital. Stop fearing a bonded off lien and start embracing it – cash is king and security is a necessity.

***Kristin Alford, NCS Education & Marketing Specialist, has assisted credit professionals throughout the US and Canada to secure their receivables through the mechanic's lien and UCC filing process.***

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