Top Ten Mistakes Leading to Loss of Lien Rights in Tennessee

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Publications

Early in my career as a construction lawyer I had occasion to appear before one of our more venerable judges. Upon learning of my practice area, the judge leaned back in his chair, peered over his readers and stated "That's mechanic's and materialmen's liens, right? I reckon that in my twenty-five years practicing law and twenty years on the bench I've seen one, maybe two, mechanics' liens that were valid!" The judge's statement was hardly an overstatement at the time. Tennessee's lien statute was strictly construed by the courts and even seemingly minor failures to comply with the statute resulted in liens being held invalid. In 2007, the Tennessee General Assembly enacted significant amendments to the statute, including a provision that the statute is "to be construed and applied liberally to secure the beneficial results, intents, and purposes." T.C.A. § 66-11-148. Nonetheless, the Tennessee mechanics' and materialmens' lien statute remains full of pitfalls and traps for the unwary and potential lien claimants should consult with a knowledgeable attorney rather than attempt to navigate the perils it poses on their own.

Tennessee's lien statute imposes differing requirements depending upon whether the lien claimant contracts directly with the property owner (a "prime contractor") or not (a "remote contractor"). Perhaps the most critical requirement for preserving a remote contractor's lien is that it must provide Notice of Nonpayment to the property owner and to the prime contractor within ninety 90 days from the end of any month in which the remote contractor supplies labor or materials for which it has not been paid. *See* T.C.A. § 66-11-145. The notice must include all the statutorily required information and must be served as set forth in the statute. Failure to send timely and proper Notice of Nonpayment results in the loss of lien rights (except as to retainage) for the period that the notice would have covered. The most common mistakes resulting in the loss of lien rights by remote contractors typically involve some aspect of the Notice of Nonpayment requirement. That having been said, the potential for other mistakes abounds. With apologies to a

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certain late night television host, here are the top ten lien mistakes of Tennessee lien claimants:

No. 1 – Focusing on the date of the bill rather than the date of the work. Remote contractors frequently fail to send a timely Notice of Nonpayment because they focus on the date when they billed the work rather than when the work was actually performed or when the materials were delivered. The 90 day time period runs from the last day of the month in which the labor or materials are supplied, not from the date when the labor or materials are billed. For example, if labor or materials are supplied in February but not billed until March, a remote contractor who has not received payment for that billing must serve Notice of Nonpayment by May 29 (31 days in March plus 30 in April plus 29 in May equals 90 days).

No. 2 – Failing to serve timely Notice of Nonpayment for unapproved change orders or extra work. This error is related to the previous mistake in that it typically results due to the lien claimant focusing on when the change order is approved or when the extra work is billed rather than when the work was actually performed. Because the approval of change order work often takes time and delays the inclusion of the change order in an application for payment, a remote contractor may frequently find itself in the situation where the deadline for sending Notice of Nonpayment is imminent, but the change order has not been approved or billed. In such situations, failure to send the notice will preclude the remote contractor from asserting a lien in the event that the change order is not issued or payment is not received.

No. 3 – Failing to scrutinize lien waivers and releases. A related mistake that costs lien claimants their rights is signing and submitting a "standard" partial lien waiver or application for payment without reserving lien rights or claims for unpaid sums. Such forms typically include language waiving all claims and lien rights through the date of the application for payment. Common errors include: (1) releasing retainage even though it has not been paid; (2) releasing extra or change order work performed within the period of the release; and (3) releasing all claims through the date of the release even though more work was performed during the period than was billed on the payment application. Accordingly,

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when a prime contractor or remote contractor has performed unbilled change order work or extra work during the period covered by the application for payment or lien waiver, it is prudent to add limiting language or an express reservation of the rights such as "This waiver does not apply to [describe change order, extra work or claim and amount thereof] and contractor expressly reserves all rights of lien or otherwise with respect thereto."

No. 4 – Failing to send the Notice of Nonpayment early enough to ensure timely receipt. The lien statute requires that the Notice of Nonpayment be served within 90 days of the last day of each month within which work or labor was provided. A notice sent on the 90th day and not received until the 91st day or later may be held untimely. Unfortunately, there currently is no case authority in Tennessee answering the question of whether such a notice is timely. Until this question is answered by Tennessee courts, remote contractors should be careful to send notice early enough to ensure its actual receipt prior to the expiration of the 90 days and thus avoid any argument that the notice is untimely. In that regard, the statute provides a rebuttable presumption that service is complete within three business days of mailing if served by registered or certified mail, return receipt requested and within one business day when sent by commercial, overnight delivery. *See* T.C.A. § 66-11-149. Because of this presumption and the ease of proving delivery, we generally encourage serving Notices of Nonpayment by commercial overnight delivery.

No. 5 – Failing to include all the required information in the Notice of Nonpayment. The lien statute requires a Notice of Nonpayment to include the following information: (1) The name of the remote contractor and the address to which the owner and the prime contractor in contractual relation with the remote contractor may send communications to the remote contractor; (2) a general description of the work, labor, materials, services, equipment, or machinery provided; (3) the amount owed as of the date of the notice; (4) the last date the claimant performed work and/or provided labor or materials, services, equipment, or machinery; and (5) a description sufficient to identify the real property against which a lien may be claimed. *See* T.C.A. § 66-11-145. In order to avoid omitting required information from the Notice of

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Nonpayment, remote contractors can take advantage of another presumption provided by the lien statute and obtain a copy of the building permit for the project when they start work. The statute provides that "the name of any owner, the owner's agent, any prime contractor, any remote contractor, or any other person, their addresses, and the real property description stated in a building permit authorizing the improvement shall be presumed to be correct and, in the case of property description, sufficient to identify the real property." T.C.A. § 66-11-149.

No. 6 – Failing to send Notice of Nonpayment to both the owner and prime contractor or sending it to an incorrect party. The lien statute requires a remote contractor to send the notice to both the owner and the prime contractor in contractual privity with the remote contractor. Many Notices of Nonpayment are defective because the remote contractor fails to send the notice to both the owner and the prime contractor or sends notice to parties who are later discovered not to be the actual owner or prime contractor. Often these errors are the result of waiting until the deadline for sending the notice and not having adequate time to investigate the correct identities of those parties. Remote contractors can generally avoid this problem if they make it a practice to send their Notices of Nonpayment in the middle of the month, rather than waiting the full 90 days. Additionally, utilizing the presumptions provided by the statute with respect to the information set forth in the building permit can simplify the process of obtaining the required information to include in the notice. Significantly, those presumptions also provide that service of the notice on the owner listed on the permit is deemed to be service on all owners, including those not listed. *See* T.C.A. § 66-11-149.

No. 7 – Failing to serve separate Notices of Nonpayment for each month for which work is unpaid. The lien statute requires that a remote contractor "shall serve, within ninety (90) days of the last day of each month within which work or labor was provided or materials, services, equipment, or machinery furnished and for which the remote contractor intends to claim a lien under this chapter, a notice of nonpayment for such work." T.C.A. § 66-11-145 (emphasis added). A court decision interpreting this provision prior to the 2007 amendments held that this required separate notices

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for each month rather than a cumulative notice covering multiple months. The amendments to the lien statute now provide that the statute is "to be construed and applied liberally" and any document that "substantially satisfies the applicable requirements of this chapter is effective even if it has nonprejudicial errors or omissions." T.C.A. § 66-11-148. These provisions may provide a basis for extricating oneself from a failure to send monthly notices; however, until this question is answered by the Tennessee courts, the safer course of action is sending multiple notices.

No. 8 – Failing to serve and record a timely written Notice of Lien. Remote contractors are required to serve written Notice of Lien to the property owner within 90 days of completion of the improvement and must also record a notice of lien in the property records of the county where the project is located within that same time. *See* T.C.A. § 66-11-115. Prime contractors do not have to serve a Notice of Lien in order to preserve their rights against the owner; however, they must record a sworn statement of lien within 90 days of completion of the improvement in order to preserve the lien against "subsequent purchasers [of the property] or encumbrancers for a valuable consideration without notice of the lien." *See* T.C.A. § 66-11-112.

No. 9 – Failing to timely and properly file suit to enforce the lien. Remote contractors are required to file suit to enforce the lien within 90 days following the service of the Notice of Lien upon the owner. Prime contractors are required to file suit within one year following the completion of the improvement. Lien suits must seek the issuance of an attachment of the property (which requires that the suit be sworn to and that an attachment bond be posted). *See* T.C.A. § 66-11-126. If the suit is not filed timely and fails to comply with the statutory requirements, the lien may be lost.

No. 10 – Failing to respond to a Notice of Completion. The time periods for serving a lien can be significantly shortened by the owner's or prime contractor's filing of a statutory Notice of Completion. If the improvement is actually complete, an owner or prime contractor may record a Notice of Completion complying with the statutory form and, upon the recording of the notice, the time for serving a lien is shortened to 10 days on residential projects

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and 30 days on commercial projects. The owner or prime contractor is NOT required to serve a copy of the notice or notify the remote contractors that the Notices of Completion has been filed UNLESS the remote contractor had previously served a Notice of Nonpayment. *See* T.C.A. § 66-11-143. This protection from a "surprise" Notice of Completion is another reason remote contractors should be diligent about serving Notices of Nonpayment.

And here's a bonus mistake:

No. 11 – Willfully and grossly exaggerating the amount for which a lien is claimed. If a court finds that a lienor has willfully and grossly exaggerated the amount of the lien claimed in a Notice of Lien, the court has discretion to allow no recovery on the lien and "the lienor may be liable for any actual expenses incurred by the injured party, including attorneys' fees, as a result of the lienor's exaggeration." Potential lienors are well advised to bear this in mind, particularly since Tennessee's lien statute excludes certain items from being included in a lien.

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