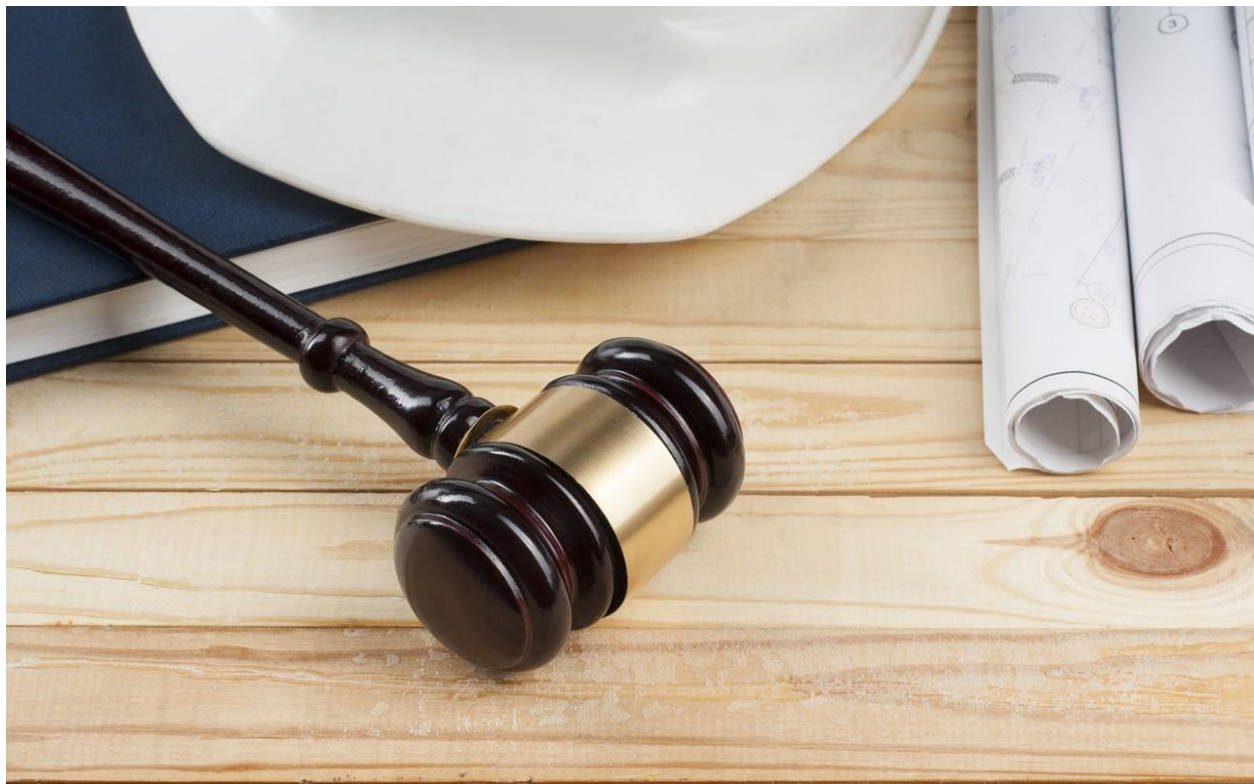




ENSURING EFFICIENT ARBITRATION OF CONSTRUCTION DISPUTES INVOLVING MECHANIC'S LIENS

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There may be tension between the enforcement of statutory mechanic's lien claims when a contractual dispute resolution provision calls for arbitration. Once the parties are in arbitration, it may not be clear whether the arbitrator has authority to make factual determinations regarding amount and validity of mechanic's liens, and whether courts are bound by these determinations. This uncertainty stems from the fact that in most states a mechanic's lien can only be enforced by a court of competent jurisdiction. Indeed, many mechanic's liens statutes define foreclosure

as a “judicial process,” and courts generally have exclusive jurisdiction to issue orders foreclosing on real property¹.

The risk for contractors and owners is that they will spend time and money re-litigating factual issues related to proving elements of a mechanic’s lien claim, including the proper lien amount, timeliness and other prerequisites. Without a clear understanding of what issues and elements are arbitrable, the parties run the risk that an arbitrator will rule on certain elements only to find out during post-arbitration lien foreclosure proceedings that the arbitrator lacked authority to make determinations on those elements. Questions therefore arise whether a court will enforce the arbitrator’s determinations and whether the parties must relitigate mechanic’s lien issues creating a further risk of inconsistent rulings.

These risks can be minimized through arbitration provisions which address these issues, express requests in arbitration demands and by ensuring that arbitration awards contain explicit determinations of mechanic’s liens issues.

The resolution of any mechanic’s lien claim requires factual determinations regarding the amount and validity of a lien. The appropriate amount of a mechanic’s lien is generally the same as the contract balance owed². Since construction disputes usually involve breach of contract claims for unpaid amounts, arbitrators will necessarily determine the contract balance owed to a lien claimant during arbitration. It is therefore efficient for arbitrators to determine the appropriate amount of mechanic’s lien claims.

Lien “validity” refers to whether a lien claimant strictly complied with state law requirements to perfect its mechanic’s lien. Some of those prerequisites include:

- providing timely pre-lien notice (in California this is referred to as a Preliminary Notice) and post-recording notice of the lien in proper form with all required information;
- proper service of the pre-lien notice on all required persons;
- timely recording of the lien; and
- timely filing of a lawsuit to foreclose on the lien.

As with the amount of mechanic’s liens, much of the evidence relevant to lien validity, including the date work commenced, the date of notice, the project completion date and the timing of any

lien foreclosure actions, etc. will likely be presented at arbitration. Since arbitrators typically consider significant evidence relevant to the amount and validity of mechanic's liens in the normal course of a construction arbitration, it is efficient and proper for arbitrators to determine these elements in arbitration.

In order to reduce the uncertainty regarding the arbitrator's authority to make factual determinations regarding the amount and validity of mechanic's liens, parties should first ensure that the arbitration provision in their construction agreements is broadly worded to encompass "all disputes" related to the project. The scope of arbitrator authority in the AIA A201 General Conditions is tied to the resolution of "Claims", which include "...any demand or assertion by one of the parties seeking, as a matter of right, payment of money, a change in the Contract Time, or other relief with respect to the terms of the Contract...[and] other disputes and matters in question between the Owner and Contractor arising out of or relating to the Contract."

This language arguably empowers the arbitrator to determine the amount and validity of mechanic's liens, but on its own, it may be insufficient to resolve uncertainty with respect to the arbitrator's authority. To remedy this, Parties should consider including language in their arbitration provisions which expressly states "To the fullest extent permitted by law, the arbitrator shall determine factual issues concerning the amount and validity of any mechanic's lien claims asserted by the parties³." This language clarifies the parties' intent for the arbitrator to make factual determinations related to mechanic's liens in arbitration, and provides courts with a justification to enforce these determinations in a subsequent foreclosure proceeding.

Addressing uncertainty regarding the arbitrator's authority to make factual determinations regarding the amount and validity of mechanic's liens is an important step, but there are other practical steps owners and contractors should take to ensure courts accept and enforce those determinations.

First, parties should expressly request determinations concerning the validity and amount of mechanic's liens in their arbitration demands and responsive submissions. If the arbitrator has apparent contractual authority to determine the amount and validity of mechanic's liens, but the parties do not expressly request these determinations from the arbitrator, the arbitration award may not contain them and issues may later arise in the trial court when proceedings ensue to

foreclose on the lien. The parties may be forced to relitigate them in a subsequent lien foreclosure action.

Second, if the award does not include the requested factual determinations concerning the amount and validity of mechanic's liens, the parties should move to correct/modify the arbitration award immediately. Courts are very deferential to arbitration awards as a matter of public policy, but the parties must ensure that the award contains all of the mechanic's lien determinations requested from the arbitrator in order for a court to enforce them. Following these recommendations will minimize the risk of having to relitigate mechanic's lien issues in post-arbitration lien foreclosure proceedings.

To be sure, there are aspects of arbitrating mechanic's lien claims that remain problematic. Since arbitration is a creature of contract, non-parties to the arbitration agreement cannot be compelled to participate in arbitration and may justifiably argue they are not bound by arbitrator determinations. This problem crops up in lien foreclosure proceedings where the priority of the lien vis-à-vis junior liens and other interests in the property will be determined by the court. There is little parties can do to eliminate this phenomenon given that foreclosure of mechanic's liens and lien priority, as noted above, is typically within the exclusive province of the courts.

Nevertheless, uncertainty regarding the scope of arbitrator authority to determine factual issues concerning the amount and validity of mechanic's liens and the potential inefficiency associated with that uncertainty can be minimized through express language in arbitration provisions, explicit requests for a determination of these issues in arbitration demands and ensuring that arbitration awards include the requested determinations. Litigating a mechanic's lien once is painful enough, litigating it twice should be avoided as much as possible.

1. Similarly, in certain jurisdictions, e.g., California, only courts have the power to order the expungement of a lien.
2. State laws may provide alternative means for determining the proper amount of a lien, e.g., limiting the value to the lesser of the contract balance or reasonable value of the work.

3. Specific state laws and/or case precedent may impact the scope of authority parties can grant the arbitrator. Parties should consult the applicable law in their jurisdiction in connection with drafting and negotiating arbitration provisions.



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