

The Impact of Arbitration Clauses on Mechanics' Liens

Recently we have had many contractors ask if they can still pursue their lien rights even though they have an arbitration agreement in their contract. We have heard others explain to us that as a matter of course they do not record mechanics' liens because they have a binding arbitration agreement in their contract. This is a confusing issue, for contractors and attorneys alike – but we will try to make it a little less so.

Please note, there are many requirements on those exercising their lien rights and this article does not cover the entire process. However, we hope to enlighten you on the issues particular to the interplay between the mechanics' lien and the arbitration clause.

First, most of us know that proper notice must be given and recorded. Most of us are also aware that, in order to perfect the lien, he/she/it must file a lawsuit to foreclose the lien within ninety days of recording the notice of lien. Because this process clearly requires a civil action, it would seem that a binding arbitration clause in the contract would supersede the ability to perfect the lien. However, there is good news, this is not the case.

Arbitration does not preclude a mechanics' lien. The short explanation is that an arbitration clause in your contract does not preclude you from recording a notice of lien or filing a lien foreclosure action. However, there is a process for navigating this tension between the lien process and the arbitration agreement.

California Code of Civil Procedure section 1281.5 provides that filing a lien foreclosure action does not amount to a waiver of a contractual right to arbitration, *if at the time the action is filed, an application for a stay of the proceeding is filed at the same time.*ⁱ Thus, the critical element is filing an application or motion for stay of the proceeding **at the same time the complaint is filed.** This is easier said than done.

How to protect arbitration after recording lien. Usually, if one party files suit where an arbitration clause is present, that party waives its right to participate in/demand arbitration. The best method of avoiding waiver is to:

- First, record the lien (and serve the stop notice).

- Second, file a demand for arbitration with the appropriate arbitration authority (usually provided for in the contract, often it is the American Arbitration Association, aka AAA) before filing suit to foreclose the lien (and enforce the stop notice).
- Third, file the foreclosure action and at the same time file a motion to stay the foreclosure action (or a stipulation for stay of the action) and include in the prayer for relief and body of the civil complaint the allegation that arbitration has been filed, is not waived, and that the plaintiff is concurrently seeking stay of the action pending arbitration.

Issues with the above procedures. There are costs associated with this plan of action. Not only are there filing fees for the complaint in state court, but there are also filing fees for arbitration, which are often greater than those in state court. Furthermore, many lien actions are paid soon after filed. Or at least they can often be negotiated and resolved shortly after the lien action is filed. Thus, it may not be worth the extra expenses of filing with the arbitrator and the cost of attorney time to do so. An alternative is to simply file the suit first, along with the concurrent motion to stay, before actually filing with the arbitrator.

An Alternative. Another approach which will provide some additional protection against inadvertent waiver of arbitration is to attach an unfiled demand for arbitration to the complaint filed in civil court. You, or probably your attorney, can also include in the complaint your intent to file the demand for arbitration. Don't forget – you or your attorney still need to file the concurrent motion for stay with the complaint. However, you can hold off, at least briefly, on making the demand for arbitration and paying the arbitration fees.

To use the lien or not. Generally, recording a lien should be several steps after the dispute/non-payment issues arise, especially for general contractors who may have other methods of obtaining payment. As already mentioned, the process of recording and foreclosing on the lien can be expensive. Additionally, recording a lien usually causes everyone to “dig in” to their position. Once a lien foreclosure action is filed, each party usually gives up something in order to resolve the issue.

However, general contractors and subcontractors alike must be careful not to allow their lien rights to expire for lack of proper notice, recording within the proper time frame (generally no more than 90 days after last work of improvement and possibly sooner), and/or complying with the many other requirements of mechanic's liens. The lien is a good stick to maintain, but we recommend negotiating prior to resorting to the lien.

In sum, you are entitled to maintain and exercise your mechanics' lien rights even if you have an arbitration agreement in your contract. However, in order to prevent waiver of arbitration, you (or your attorney) must file a motion to stay the proceeding at the same time the lien foreclosure action is filed.

Also, a quick reminder: There are many complicated and tedious requirements to perfecting/executing the mechanic's lien, which are not discussed in this article. Please contact an attorney if you are in need of advice regarding this process.

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As always, these articles are summary discussions only - to simply give you a heads up on various construction topics. The information contained herein is not legal advice. Each scenario is different and if you need legal advice you should contact an attorney immediately.

ⁱ See also *Baker v. Motel 6, Inc.* (1986) 180 Cal.3d 928; *Lambert v. Superior Court* (1991) 228 Cal.3d 383