

# YoungWilliams P.A.



## Basic Rules Regarding Liens & Stop-Payment Notices

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Steve Williams specializes in business litigation, arbitration, construction claims and disputes, commercial collections, contract negotiations and contract disputes and the needs of those involved in the construction industry. He has represented owners, contractors, subcontractors and suppliers in almost every type of construction setting including contract preparation, negotiations, bidding, claims, disputes, litigation and arbitration.

He is a trial attorney who has practiced in all Courts, state and federal. He is experienced in appellate work and is admitted to practice before the United States Supreme Court. Steve received his Juris Doctor from the University of Mississippi School of Law in 1975 where he was a staff member of the Mississippi Law Journal for two years and business manager of the Mississippi Law Journal from 1974 to 1975. Steve received his AB degree in Economics from Davidson College, Davidson, North Carolina, in 1972. He graduated from Clinton High School in 1968. Steve is a member of the American Bar Association, the Mississippi State Bar, and the Hinds County Bar Association. He served as president, vice-president, secretary and treasurer over various years for the Jackson Young Lawyers Association.

## **BASIC RULES REGARDING LIENS AND STOP PAYMENT NOTICES**

### **A. Introduction**

“When working toward the solution of a problem, it always helps if you know the answer.” Rule of Accuracy

Construction liens, stop notices and bonds on private and public work in Mississippi are separate and distinct mechanisms available to persons involved in the construction process to enforce payment for construction services and materials used to improve real property. Each statutory mechanism is designed for use in specific circumstances. In essence, who you are (owner, prime, subcontractor, supplier, sub-subcontractor) and with whom you contract (see Table 1), determines your right to use or avoid a construction lien, a stop payment notice or a bond claim.

### **B. Lien Rights**

“The man who can smile when things go wrong has thought of someone he can blame it on.” Jones’ Law

#### 1). What is a lien and who has one?

When a construction project is not bonded, Mississippi law provides a construction lien which can be used to enforce payment by obtaining a judgment against the owner’s improved property and selling it to satisfy the debt due the lien holder. Miss. Code Ann. §85-7-131 grants a lien right to those persons who have a direct contractual relationship with the owner of the property or his agent. The statute provides:

Every house, building, water well or structure of any kind, and any fixed machinery, gearing or other fixture that may or may not be used or connected therewith, railroad embankment, erected, constructed, altered or repaired, and every subdivision of property or subdivided property which required services, designs or construction in designing or laying out of streets or subdividing or construction of streets, sewerage,

water or other utilities to be furnished by the said subdivision or by the various owners or holders or creators of said subdivision or subdivided property or individual lot or lots in connection therewith, whether inside of a municipality or outside thereof, shall be liable for the debt contracted and owing, **for labor done or materials furnished**, or architectural engineers' and surveyors' or contractors' service rendered about the erection, construction, alteration or repairs thereof; and debt for such services or construction shall be a lien thereon. The architects, engineers, surveyors, laborers, and materialmen and/or contractors who rendered services and constructed the improvements shall have a lien therefor. . . . If such house, building, structure, or fixture be in a city, town or village, the lien shall extend to and cover the entire lot of land on which it stands and the entire curtilage thereto belonging; or, if not in a city, town or village, the lien shall extend to and cover one (1) acre of land on which the same may stand, if there be so much, to be selected by the holder of the lien. If the structure be a water well, the lien shall extend only to all pumps, pipes, equipment therein and all water well appurtenances. . . . If the structure be a railroad or railroad embankment, the lien shall extend to and cover the entire roadbed and right-of-way, depots and other buildings used or connected therewith. If the services of the architect, surveyor, engineer, laborers, materialmen or of the contractors shall be upon the whole subdivision, the lien shall extend to and cover the entire subdivision; but if a part only of the land is subdivided and laborers', materialmen's, architects', surveyors' or engineers' services are required and contractors are employed, then the lien shall extend to only that portion of said property upon which the services were required or upon which or in connection with which the work was done or the materials were furnished. Such lien shall take effect as to purchasers or encumbrancers for a valuable consideration without notice thereof, only from the time of commencing suit to enforce the lien, or from the time of filing the contract under which the lien arose, or notice thereof, in the office of the clerk of the chancery court, as hereinafter stated; delivery of material to the job is prima facie evidence of its use therein, and use of water from a water well is prima facie evidence of acceptability of well. . . .

M.C.A. § 25-7-131 (emphasis added).

As stated in the statute, lien rights are available to architects, engineers, surveyors, laborers, suppliers and contractors who have rendered services or provided materials which improve the property. However, the lien right exists only in favor of the contractor employed by the owner or the material supplier from whom the owner has purchased materials. See, Brown v. Gravlee Lumber Co., Inc., 341 So.2d 907 (Miss. 1977); Wenger v.

First National Bank, 164 So. 229 (Miss. 1935). This rule is codified in §85-7-135 which states:

The lien declared in section 85-7-131 shall exist only in favor of the person employed, or with whom the contract is made to perform such labor or furnish such materials or render such architectural service, and his assigns, and when the contract or employment is made by the owner, or by his agent, representative, guardian or tenant **authorized**, either expressly or impliedly, by the owner.

M.C.A. § 85-7-135. (emphasis added).

There is no requirement that the lienable debt be based upon a written contract. The underlying debt can be verbal. Taylor v. Murphy, 203 So. 2d 82 (Miss. 1967); Delta Lumber Co. v. Wall, 80 So. 782 (Miss. 1919). Additionally, the lien statute has been construed liberally in order to protect its underlying purpose. In Brown v. Gravlee Lumber Co., Inc., 341 So. 2d 907 (Miss. 1977), the Mississippi Supreme Court stated:

[A] liberal construction of the word ‘authorized’ in section 85-7-135 is necessary to effectuate the probable intent of the Legislature. The statute seeks to protect the workman who might otherwise go uncompensated for his labor. A restrictive definition of authorization would undermine that beneficent purpose.... The knowledge and consent of the owner are sufficient to invoke the protection of section 85-7-135.

Id. at 910.

In some situations, it may be possible to claim that the contracting party, while not the “owner” of the property, is the “agent” of the owner for purposes of claiming a construction lien on the property. After all, the statute refers to a contract made by the owner “or by his agent.” In Bailey v. Worton, 752 So.2d 470 (Miss. App. 1999), the Mississippi Court of Appeals held that a general contractor could be the implied agent of the owner sufficient to uphold a lien claimed by a subcontractor against the property where the

general contractor had apparent authority to bind the landowner and the subcontractor acted in reliance on that authority to his detriment.

The Bailey case is very limited in its scope and should not be relied upon without the specific advice of counsel. In that case, the subcontractor asserting the lien had to prove specifically that (1) the owner's acts indicated the general contractor's authority as his agent, (2) the subcontractor relied on that authority, and (3) the subcontractor changed his position to his detriment. Id. at 475. In most cases, a subcontractor has no lien rights.

Individuals not having a direct contractual relationship with the property owner (Table 1) often file a notice of construction lien in an attempt to get paid. In doing so, they subject themselves to potential liability through litigation for wrongful filing.

The owner might base his suit on Miss. Code Ann. §85-7-201 or slander of title. Miss. Code Ann. §85-7-201 renders anyone who falsely and knowingly files an erroneous construction lien liable to every person injured by the notice for the full amount of the claim. A federal district court decision interpreting this statute held that the "knowing" language of the statute required a plaintiff to establish that the filing was made in bad faith. Manderson v. Ceco Corp., 587 F. Supp. 445 (N.D. Miss. 1984).

Another possible basis for imposing liability for an erroneous filing is a slander of title suit. In order to prove a claim of slander of title and recover damages, the plaintiff must establish that the filing constituted a false and malicious act. Walley v. Hunt, 54 So. 2d 393, 396 (Miss. 1951). Although claims based on Miss. Code Ann. §85-7-201 and slander of title require a heavy burden of proof by the owner, the prudent contractor will be sure that he is entitled to a construction lien prior to filing his notice of a construction lien.

Miss. Code Ann. §85-7-201 provides:

Any person who shall falsely and knowingly file the notice mentioned in section 85-7-197 without just cause shall forfeit to every party injured thereby the full amount for which such claim was filed, to be recovered in an action by any party so injured at any time within one year from such filing; and any person whose rights may be adversely affected may apply, upon two days' notice, to the chancery court or to the chancellor in vacation, or to the county court, if within its jurisdiction, to expunge; whereupon proceedings with reference thereto shall be forthwith had, and should it be found that the claim was improperly filed rectification shall at once be made thereof.

The second portion of the statute provides an extraordinary remedy to any one whose “rights may be adversely affected” by a wrongfully filed lien. Such a person may obtain a hearing in Chancery Court or County Court upon 2 days notice to have the lien expunged from the land records. The jurisdiction of the Chancery Court and the use of the statute for this purpose were affirmed in 1999 in the case of Cummings v. Davis, 751 So. 2d 1055 (Miss. App. 1999). In that case, there is no mention of a requirement that the lien be “falsely and knowingly” filed.

(2). Construction Lien Filing Requirements.

Miss. Code Ann. §85-7-131 contains specific requirements for filing a notice of construction lien. Specifically, the statute states that the notice of a construction lien “shall not take effect until some notation thereof shall be filed and recorded” in the Notice of Construction Lien book in the Chancery Clerk's office of the county where the property is located. Miss. Code Ann. §85-7-133. The lien will take effect and have priority over subsequent purchasers or encumbrances from the time suit is filed to enforce the lien or from the time of filing the notice of a construction lien. Self v. Nelson, 402 So. 2d 822 (Miss. 1981).

In addition to filing a notice of construction lien in the notice of construction lien book, the contractor may file a notice of construction lien in the lis pendens record in the Chancery Clerk's office in the county where the property is located. However, in order to file the claim in the lis pendens record, the contractor must meet certain technical requirements of Miss. Code Ann. §85-7-197. The contractor must file a written affidavit stating:

1. The basis of the claim;
2. All parties to the claim;
3. All persons affected by the lien;
4. A description of the property; and
5. The rights claimed in the property.

Additionally, the contractor must notify the owner in person or by certified mail that the notice has been filed. In order to obtain the most protection, the contractor should file in both the lis pendens record and the Notice of Construction Lien book. Hicks v. Greenville Lumber Company, 387 So. 2d 94 (1980).

(3). Enforcing the Lien.

The mere filing of a notice of construction lien does not entitle the contractor to be paid. In order to enforce the lien right, the contractor or material supplier must file suit to enforce the payment obligation.

Suit to enforce a construction lien must be filed in the county where the property is located within 12 months of the date the debt became due and payable. Miss. Code Ann. §§ 85-7-131 and 85-7-141. When materials have been delivered to the project in installments and no date for payment is contained in the contract, the one year statute of limitations

begins to run from the date of delivery of the last lot of materials. Billups v. Beckers Welding and Machine Company, 189 So. 526 (1939).

The one year statute of limitations has been strictly applied, and the contractor must file suit to enforce the lien within one year of the debt first becoming due and payable and not one year from the date of filing the notice of a construction lien. See Central Grain & Supply Co., Inc. v. Jesco, 410 So.2d 879 (Miss. 1982).

In years past, enforcing a lien right could be expensive and sometimes rendered the lien right impractical. In 1987, the Mississippi legislature amended section 85-7-151 to allow the lien claimant to recover its "reasonable attorney's fees"<sup>1</sup> to enforce the lien. This provision should prove especially useful to holders of small lien claims. The statute is quoted below:

In case judgment be given for the plaintiff against the builder, it shall, in case he was actually served with process, be entered against him generally, with costs, as in other cases, and with attorney's fees as provided below, and with a special order for the sale of the property upon which the lien exists for the payment thereof, and for an execution, as in other cases, for the residue of what may remain unpaid, after the sale of the property; and if the defendant be brought in by publication only, and have not appeared, the judgment shall be entered specially for the debt and costs, to be made of the property in the petition described; and in case a general judgment be not given against the builder, such proceedings or recovery shall not be a bar to any suit for the debt, except for the part thereof actually made under such recovery. **When judgment is rendered in favor of the plaintiff against the builder, the builder shall be liable for reasonable attorney's fees to be set by the judge for the prosecution and collection of such claim.**

The provisions of this section allowing the award of attorney's fees shall only apply to actions the cause of which accrued on or after July 1, 1987.

M.C.A. § 85-7-151 (emphasis added).

(4). Priority.

Questions of priority on the sale of the property can take many forms. The most frequent priority question arises in the relationship between a contractor who has filed a construction lien and that of a bank or other financial institution which made a construction loan to the owner secured by a deed of trust on the property. In this situation, the financial institution will prevail if the deed of trust was filed prior to any work being done on the property or the filing of a construction lien.

However, some special rules govern construction loans secured by a deed of trust and their priority over a construction lien. Specifically, the deed of trust is superior to a construction lien only to the extent the loan proceeds were actually used for construction purposes or where the lender can show that "reasonable diligence" was used in disbursing the loan proceeds. Wortman and Mann, Inc. v. Frierson Building and Supply Company, 184 So. 2d 857 (Miss. 1966); and Guaranty Mortg. Co. of Washville v. Seitz, 367 So. 2d 438 (Miss. 1979). Although "reasonable diligence" has not been absolutely defined, at a minimum it requires the lender (i) to obtain affidavits from the owner that no debt is owed to contractor and suppliers and (ii) to check the land records for construction lien filings. Deposit Guaranty National Bank v. E.Q. Smith Plumbing & Heating, Inc., 392 So. 2d 208 (Miss. 1980).

Another instance where questions of priority have arisen is between the construction lien claimant and subsequent purchasers or encumbrances. The classic illustration of this type of priority dispute occurs when subsequent to the filing of a construction lien notice, the owner of the property sells or conveys the property to a third party. In this case, the

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<sup>1</sup> The statute refers to a judgment "in favor of the plaintiff against the builder." Although no case addresses the issue, it is unclear whether "builder" refers to the owner or the contractor, although presumably, it means the owner.

contractor/lien holder will generally prevail provided he has met the filing requirements of Miss. Code Ann. §85-7-131. Southern Life Insurance Company v. Pollard Appliance Company, 150 So. 2d 416 (1963).

(5) Expungement of Improper Notice of Lien and Penalties

If a construction lien filed in the lis pendens record has no merit or is otherwise improper, the owner has a remedy available to expunge or remove the lien. Miss. Code Ann. § 85-7-201 allows an owner to petition the Chancery Court (or County Court if available) to expunge the construction lien. This can be sought any time within one (1) year of the filing of the lien. Additionally, persons considering filing a construction lien in the lis pendens record should be aware that there are possible ramifications to an improper use of these liens. Miss. Code Ann. § 85-7-204 provides for statutory penalties against any person or entity who “falsely and knowingly” files a notice of lien in the lis pendens record without just cause. Miss. Code Ann. § 85-7-201 (Supp. 2004).

While the statute has been interpreted as being “penal in nature” which requires one to “clearly prove” that the lien was filed “falsely, knowingly, and without just cause,” the possibility of these penalties should always be considered. Manderson v. Ceco Corp., 587 F. Supp. 445, 446-447 (N.D. Miss. 1984). This federal court decision is the only reported decision interpreting this part of the statute, and it seems to have imposed a significant burden for obtaining recovery. The Court held that the filing of the lien would have to be “done with an evil or bad purpose” in order to constitute a knowing violation. Manderson, 587 F. Supp. at 447. However, every one involved should be aware of this statute and its possible ramifications.

**C. Stop Payment Rights**

“Whoever has the gold makes the rules.” The Golden Rule of Arts & Sciences

(1). What are they and who has them?

Although subcontractors and suppliers of the prime contractor do not have lien rights, they do have rights that prevent distribution to the prime contractor of funds due under the prime contract. This is accomplished by giving the owner written notice of the nonpayment and a demand that the prime contractor not be paid until the debt due the subcontractor or the prime's supplier is satisfied. Miss. Code Ann. § 85-7-181.

The right to file a stop payment notice is limited to subcontractors and suppliers who have a direct contractual relationship with the prime contractor (see Tier I, Table 1).

Associated Dealers Supply, Inc. v. Mississippi Roofing Supply, Inc., et al., 589 So.2d 1245, 1247 (Miss. 1991); Monroe Banking and Trust Company v. Allen, 286 F. Supp. 201 (N.D. Miss. 1968).

The filing of a stop payment notice does not initially create any rights in the owner's property. Thus, a contractor who files a stop payment notice cannot file suit and force the sale of the property to pay the indebtedness. Instead, the notice has the effect of binding the general contractor's money in the hands of the owner for the payment of the amount due the subcontractor. If the proceeds owed the prime contractor are insufficient to cover the claim, then the proceeds are bound pro rata for all claims due. Miss. Code Ann. §85-7-181.

A stop payment notice served after the owner has made payment to the prime contractor is of no effect. Corrugated Industries, Inc. v. Chattanooga Glass Company, 317 So. 2d 43 (Miss. 1975). The Mississippi Court of Appeals, citing Corrugated Industries, Inc., recently held that a subcontractor who fails to file a stop payment notice with the owner will stand “only as a general creditor” of the prime contractor with no right of recovery directly

against the owner. Noble House, Inc., v. W&W Plumbing & Heating, Inc., 881 So. 2d 377, 385 (Miss. App. 2004).

Therefore, it is clear that a subcontractor will have no right to direct recovery against the owner if a stop payment notice pursuant to Miss. Code Ann. § 85-7-181 is not (1) actually served on the owner and (2) served timely. However, if the owner pays funds to the prime contractor after receiving the stop payment notice, the stop payment notice will constitute a lien on the project to the extent of the funds released by the owner. Additionally, a stop payment notice is only effective to bind funds in the hands of the owner. A stop payment notice is ineffective to bind funds in the hands of the prime contractor. Redd v. L & A Contracting Co., 151 So. 2d 205 (Miss. 1963).

(2). Delivery and filing requirements of a stop payment notice.

A stop payment notice is effective upon delivery of written notice to the owner stating the amount due. Miss. Code Ann. §85-7-181. Although the statute does not require any specific means of delivering the written notice, it probably should be hand delivered and/or delivered by certified mail.

Miss. Code Ann. § 85-7-197 allows the party serving a stop payment notice to record his claim in the lis pendens record of the county where the contract was performed. The filing places any subsequent purchasers on notice that any purchase or encumbrance can be subject to the stop payment right.

(3). Enforcing a stop payment notice.

If the subcontractor or supplier is not paid, suit must be filed to enforce the stop payment notice. Suit should be filed in the county where the contract was performed, and all

parties having an interest in the funds should be named in the suit. Miss. Code Ann. § 85-7-181.

If the owner denies any indebtedness to the prime contractor, the case can be tried and a judgment rendered. If judgment is rendered against the owner, the judgment becomes a lien on the property which dates back to the delivery of the original notice. However, the owner's liability is limited to the amount owed to the general contractor under the contract. Miss. Code Ann. § 85-7-181 allows the party filing suit to recover attorney's fees incurred in enforcing the stop payment right.

(4). Effect of a Surety Bond on Stop Payment Notices

While the presence of a surety bond has far reaching effects, the consequence appropriate for this section is that the posting of a surety bond on a private construction project precludes the filing of stop payment notices by subcontractors and suppliers. The payment bond is considered to be in lieu of stop payment rights afforded to subcontractors and suppliers. Dickson v. USF&G, 117 So. 245 (Miss. 1935). The Mississippi Supreme Court has verified the holding in Dickson by quoting the portion of the opinion as follows:

The purpose of the bond section of the statute was to provide for the protection of materialmen and laborers, the bond being in lieu of their equity in the funds arising out of the building contract.

Erwin Engineering Corp. v. Deposit Guaranty Bank & Trust Co., 62 So. 2d 572, 574 (Miss. 1953).

Therefore, if an owner receives a stop payment notice pertaining to a bonded project, he should notify the sender that the project is bonded. Additionally, his legal counsel should follow-up with a letter that the stop payment notice is a nullity due to the surety bond.

#### **D. Conclusion**

Payment rights on construction projects in Mississippi require familiarity with state and federal law, a number of statutes and several surety bond forms. Persons seeking to protect their obligations to make or their rights to receive payments should carefully review the statutes and follow their requirements closely. Construction owners, contractors, subcontractors and suppliers should always discuss the facts of their situation with an experienced construction lawyer.