



# MECHANIC'S LIENS & UCC LIENS – TOOLS FOR SECURING PAYMENT

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- Minnesota Underground Utilities Contractor's Association
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# OVERVIEW

- 10,000 Foot View of Mechanic's Liens and UCC Liens
- A comparative perspective
  - What are they?
  - Similarities & Differences
  - How can they be utilized to enhance collection efforts?

# DEFINITIONS

- What is a “mechanic’s lien”?
- For this presentation, a mechanic’s lien is an involuntary lien encumbering real property
- What is a “UCC Lien”?
- For this presentation, a UCC Lien is a voluntary lien encumbering personal property



# WHEN IS A MECHANIC'S LIEN USED?

- The most common use of a mechanic's lien is to secure payment obligations to contractors, subcontractors and material suppliers who contribute labor and or materials to the improvement of real property



# WHEN IS A UCC LIEN USED?

- The most common use of a UCC lien is to secure payment obligations to a person that extends credit or loans money to another



# WHAT IS THE AUTHORITATIVE SOURCE FOR MECHANIC'S LIENS?

- Mechanic's liens are creatures of state statute
- The procedures for creating, perfecting, and foreclosing mechanic's liens vary greatly between jurisdictions



# WHAT IS THE AUTHORITATIVE SOURCE FOR UCC LIENS?

- UCC stands for Uniform Commercial Code
- Technically, the UCC is not a set of laws itself, but is a model set of laws that individual states follow
- Each state has its own implementation of the UCC rules, but the rules do not vary much state to state
- There is no model or uniform code applicable to mechanic's liens



# CREATING AND PERFECTING A MECHANIC'S LIEN

- In many states, a mechanic's lien attaches automatically to a parcel of real estate when someone contributes labor or material for the permanent improvement of the real property
- Pre-lien Notification: to preserve a mechanic's lien, a prelien notification may be required depending on the type of construction project and the status of the person holding mechanic's lien rights
  - The purpose of prelien notification is to put the owner/general contractor on notice that the person is contributing labor and/or materials with the expectation of being paid
  - During the course of a construction project, it is common for interim pay applications to be processed in exchange for partial lien waiver
  - Many states differentiate between construction projects that are residential and commercial in nature
  - Some states have different prelien notification requirements for person in privity of contract with the project owner and those not in privity of contract



# CREATING AND PERFECTING A MECHANIC'S LIEN

- **Lien Statement:** to perfect a mechanic's lien, generally a lien claimant must file/record and serve a mechanic's lien statement
  - Generally, identifies the real property encumbered by the lien; the owner of the property; the contractor that requested the contribution; the type of contribution made; and the amount owed
  - Timing of filing/recording a mechanic's lien statement is governed by statute and strictly construed, typically calculated from the last contribution of labor and or materials
  - Recorded in the property records division of a state or the clerk of court in the county in which the real estate is situated



# CREATING AND PERFECTING UCC LIENS

- UCC-1 is the uniform form filed by the creditor in the Office of the Secretary of State, in the state the debtor is located, to obtain a lien on specified collateral
  - A UCC-1 may be recorded in property records in the county in which real estate exists if the collateral is tied to a particular piece of real property, such as timber, mineral rights, or fixtures
- A prerequisite to filing a UCC-1 is the execution of a security agreement by the lender/seller and borrower/buyer
- Both parties agree to the security agreement that identifies the material, equipment, and/or assets being used as collateral
- The most common scenario for the filing of a UCC Financing statement is in conjunction with the execution of a promissory note and security agreement in exchange for money lent. It is also commonly utilized in equipment financing transactions, and factoring agreements.
- The UCC-1 Financing Statement is utilized to perfect the creditor's security interest in the collateral



# UCC FINANCING STATEMENT/UCC-I FILINGS EXPLAINED

- Pursuant to UCC 9-503 and 9-504, the financing statement need only contain three pieces of information:
  - The debtor's name and address
  - The creditor's name and address
  - An indication of the collateral, "whether or not it is specific, if it reasonably identifies what is described (UCC 9-108)
- Two types of UCC-I Filings
  - UCC liens against specific collateral: this type of lien gives a creditor an interest in one or more specific, identified assets rather than an interest in all the assets owned by a business. These are typically utilized in inventory financing or equipment financing transactions
  - UCC Blanket liens: this lien gives a creditor a security interest in all assets of a borrower. This lien is commonly used for loans from banks and alternative lenders.
- Typical Collateral
  - UCC-I filings typically use moveable assets as collateral, which can include office equipment and fixtures, investment securities, inventory, accounts receivables, letters of credit, and other tangible items of value.

# DRAFTING COLLATERAL DESCRIPTIONS

- UCC 9-108, Sufficiency of Description, requires a security agreement to “reasonably identify” the collateral. Examples of ways to reasonably identify the collateral include:
  - Specific Listing
  - Category
  - Type of collateral defined in the UCC
  - Quantity
  - Any other method if the identity of the collateral is “objectively determinable”

# 6 COMMON ERRORS IN DRAFTING COLLATERAL DESCRIPTIONS

- #1 – Incorrect Categorization
- #2 – Wrong Dates or Numbers
- #3 – Unnecessary Limiting Phrases
- #4 – Failure to Include After-Acquired Property Clause
- #5 – Failure to Anticipate Changes in Collateral
- #6 – Inconsistency between Security Agreement and Financing Statement

# LIEN PRIORITY

- Mechanic's lien priority is established by state law. Sometimes priority is established by date of recording the lien statement, and other times all mechanic's lien claimants on a specified construction project have coordinate priority beginning from the project's inception
- UCC-1 priority is typically established from the date of filing the financing statement with the secretary of state's office.

# DURATION AND DISCHARGE OF LIEN

- A mechanic's lien encumbers a parcel of real estate for the amount of time specified in state law. It is common for the duration to be between one and 2 years. If an action to foreclose the lien within the specified period of time is not commenced, the mechanic's lien ceases to be a cloud on title.
- A mechanic's lien may be discharged prior to perfection by execution of a full and final lien waiver
- A mechanic's lien may be discharged by the recording of a lien satisfaction after perfection
- A UCC lien typically has a five-year term, which may be renewed by the creditor
- A UCC lien may be discharged by filing a UCC-3 Termination with the secretary of state's office

# ENFORCING LIEN RIGHTS

- Mechanic's lien foreclosure action
  - Legal action commenced in county in which real estate encumbered by the mechanic's lien is situated
  - In-rem action (against the property)
  - Name all parties with a record interest in the real estate
  - Court to determine amount and validity of mechanic's lien, and relative priority of the parties
  - Seek an order foreclosing the lien and authorizing disposition of the real estate at sheriff's sale
  - Generally, no jury available
  - Whether a deficiency judgment may be awarded post-sale is a matter of state law

# ENFORCING LIEN RIGHTS

- Collection and enforcement of UCC lien on pledged collateral
  - A secured party must act in commercially reasonable manner when exercising its direct collection rights (UCC 9-607(a)(1))
  - The Remedy of Repossession
    - Cannot hold collateral indefinitely, and has duties with respect to the collateral it holds, including maintenance, reasonable disposition, and the duty to take reasonable care of collateral in its possession.
    - After default, the secured party may take possession of collateral either with judicial process, or without judicial process if there is not breach of peace (UCC 9-609(b))
    - If collateral is an object too large to move, the secured party may render the collateral unusable and dispose of it on the debtor's premises after default (UCC 9-609(a)(2))
    - Secured party is responsible for its agent's action and can be liable for unreasonable repossession conducted on its behalf

# ENFORCING LIEN RIGHTS

- Disposition
  - Disposition is the secured party's primary Article 9 remedy. It includes any sale, lease, license, or other disposition of collateral (UCC 9-610(a))
  - Secured party may dispose of any or all collateral either in its existing condition or following commercially reasonable processing
  - Public versus Private Sale – Secured party may dispose of property through a public or private sale (UCC 9-610(c)). Public sale or auction following public notice. In a private sale, the secured party seeks out interested parties and agrees to terms without an auction. The decision to go private or public sale must be made in a commercially reasonable manner
  - Notification prior to disposition of collateral (UCC 9-611) – prior to disposition, the secured party must send notification of its intent to dispose of the collateral to the debtor (a few exceptions such as waiver after default, perishable collateral, and recognized market pricing), secondary obligors, other secured parties or lienholders who have requested in advance to be notified, and any secured parties or lienholders of record. 10 day notice is considered per se reasonable.
  - Application of Proceeds to Disposition; Liability for Deficiency and Right to Surplus (UCC 9-615)

# ENFORCING LIEN RIGHTS

- Acceptance of Collateral
  - UCC 9-620 allows a secured party to accept collateral in total satisfaction of the secured debt (or partial satisfaction for non-consumer agreements) if it complies with two requirements
    - Acquiescence by debtor
    - Confirmation no parties entitled to notice

## **IN CONCLUSION**

Please call or email me if you have any questions about your specific situation.

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