

General Contractors Take Note: Beware of Waiving Your Mechanics Lien Rights Through a Subordination Agreement

By Sumner D. Widdoes, Esq.

In the constant battle to ensure priority of mechanics lien rights and claims, general contractors, subcontractors and material suppliers often find themselves at the mercy of the party with superior bargaining power – the owner or lender. In California, the weakest parties, often subcontractors and material suppliers, are protected by statutes that prohibit lenders and general contractors from waiving or impairing their liens and claims. But general contractors are not afforded such protection, as the appellate court made clear recently in *Moorefield Construction, Inc. v. Intervest-Mortgage Investment Company, et al.*, D065464, 2014 WL 4823609 (Cal. Ct. App. September 12, 2014).

In *Moorefield*, the general contractor (“GC”) sought to enforce its mechanics lien against the medical office facility it constructed after the Owner failed to make the GC’s final two payments. The GC then filed suit against the Owner and Lender, which also had a lien on the property and sought to enforce it as a result of the Owner’s default. In response, the Lender filed a cross-complaint seeking to enforce the consent agreement signed by the GC, in which the GC agreed to subordinate any claims it had on the property in exchange for the loan Lender provided Owner.

The lower court agreed with the GC that the GC’s lien had priority over the Lender’s construction trust deed and that the subordination agreement was unenforceable. On appeal, however, the court made it clear that general contractors will not be protected by statute from subordination agreements that effectively waive their mechanics lien rights. So long as the GC consents to the agreement, it is free to waive its rights as it pleases.

The Court came to this conclusion after a thorough analysis of former California *Civil Code* sections 3262, which prohibited lenders and general contractors from impairing the rights of “other persons,” and 3268, which allowed parties to contract around statutory protections with

regard to their own claims and rights. The court found that the former statute clearly protected subcontractors and material suppliers from being forced to waive lien rights as a condition of securing a contract, while the latter section clearly permitted general contractors to waive any rights it pleased, so long as there was consent. In *Moorefield*, the GC's consent was not at issue, which led the court to the consequential determination that the GC's subordination of lien rights to the Lender was enforceable, even when such a waiver was required in order to secure the contract.

As a result, the *Moorefield* case may solidify the superior bargaining power of owners and lenders, who can require general contractors to subordinate lien claims as a condition of the contract. This decision only reinforces the importance of alternative recovery mechanisms, such as stop payment notices, that allow general contractors to impose a lien upon construction funds on private lender-funded projects. Moreover, general contractors should carefully review proof of an owner's financing before commencing work and at various project milestones. For those private projects that qualify, the general contractor should consider insisting that owners comply with California law by posting project security for the benefit of the general contractor pursuant to Civil Code section 8700 *et seq.* Finally, general contractors should try to negotiate into their contracts the right to stop work or terminate for payment delays.

For more information contact:

[Sumner D. Widdoes, Esq.](#)

Gibbs Giden Locher Turner Senet & Wittbrodt LLP

1880 Century Park East, 12th Floor

Los Angeles, California 90067

Phone: (310) 552-3400

email: swiddoes@ggltsw.com

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