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# REAL ESTATE WEEKLY

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## Mechanics liens, bonds and insolvency

By **KEVIN J. CONNOLLY**  
**ANDERSON KILL & OLICK P.C.**

Surety bonds are highly useful to construction lawyers and conveyancers when dealing with mechanics' liens. The laws governing mechanics' liens and the use of bonds to protect against lien enforcement vary from state to state, but in almost all states, the standard solution when a mechanic's lien has been filed is to cancel the lien by filing a bond.



This removes impediments to the flow of money for work in progress and enables the owner to convey or mortgage the property free and clear of the lien.

What if the surety on the bond becomes insolvent?

Prior to the recent reverses in the financial markets, this question was rarely considered. Until quite recently, the question was dismissed out of hand as being of concern only to alarmists or neophytes who are ignorant of the realities of the marketplace. Today, however, the question no longer seems to be so outlandish.

The result will depend in no small part on the mechanics' lien act of the pertinent state. In a state such as Illinois, where there is no mechanism short of settlement or judgment to eliminate a lien, the insolvency of a surety makes no difference, because

securing a bond has no legal effect.

In most jurisdictions, however, the filing of a surety bond is held to discharge the lien. In *Re Trustees of German Lutheran Evangelical Congregation*, 44 MD 457 (1976), the court held that the lien having been discharged by filing a bond, the subsequent insolvency of the parties liable on the bond was not a basis for reinstating the lien.

New York's law is contrary. In *Re B. Lindner & Bro.*, 147 Misc. 51, 262 NYS 821 (Sup. Ct. NY County 1933), a mechanic's lien had been discharged by filing a bond. When the bond proved to be worthless, owing to the insolvency of the principal and the surety, the lienor petitioned the court to reinstate the lien unless the owner furnished new or additional security. That petition was granted on the strength of §149 of the Civil Practice Act:

'§ 149. Additional security. Where a bond or an undertaking has been or shall be given in an action or a proceeding, further or other security may be ordered in addition to such security. Upon cause shown an examination or re-examination of any surety upon any such undertaking may be ordered and upon such examination or re-examination a new surety or sureties may be required to be furnished or further or other security to be given in addition to the security already given. Such order may be enforced by any disposition of the action or proceeding as may be proper.'

New York recodified its civil procedure law in 1964, the substance of CPA §149 was carried forward into CPLR §2508, but the last sentence of §149 was not re-enacted. Instead, the Court was granted very broad powers to handle surety bonds:

Upon motion of any interested person, upon notice to the parties and surety, and to the sheriff, where he was required to be served with the undertaking, the court may order a new or additional undertaking, a justification or rejustification of sureties, or new or additional sureties. Unless otherwise provided by order of court, a surety, on the undertaking shall remain liable until such order is complied with, but the original undertaking shall be otherwise without effect.

The provision of CPLR 2508 that the original undertaking is without effect if the court grants relief under the statute is telling when compared to the terms of Lien Law §19(a), which permits the discharge of the lien by filing a bond: "The undertaking is effective [to discharge the lien] when \* \* \* served and filed." If the original undertaking becomes "without effect," as provided in CPLR 2508, then it can no longer be effective to discharge the lien.

It should not be assumed that a court will order relief under CPLR 2508 whenever a surety company encounters financial difficulty. The Lindner case mandated new or additional security, but in that case, the bond had become "worthless." The New York Insurance Department has powers to rehabilitate or liquidate an insurance company that is under its supervision, and those powers include marshalling the assets of the insurance companies and the claims against them.

The extreme rarity of cases in which additional security has been sought testifies that as of yet, there has been no flood of "worthless bond" cases in the courts. If that event does come to pass, however, the law in New York is clear: the lien can be reinstated in a proper case. What priority of lien will attach after reinstatement remains an open question. ■