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Nevada Supreme Court Rules Pay-If-Paid Clause Unenforceable

By Leon F. Mead II, Esq.

In another disappointing decision for general contractors arising out of the Venetian Mechanics Lien litigation, the Nevada Supreme Court has struck down pay-if-paid contract provisions as violating Nevada public policy. In *Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc., et al.*, 124 Nev. Adv.Op. 39 (June 2008), the project owner and an out-of-state general contractor used a poorly worded waiver of the subcontractor's mechanics lien right in conjunction with a pay-if-paid provision to attempt to argue that neither had an obligation to pay the subcontractor for its work. The trial court concluded "that the pay-if-paid provision was unenforceable as a matter of public policy because '[i]t deprives people who work on construction projects of a statutory right' to a mechanics lien." On appeal, the owner and general contractor argued that the trial court erred by holding both the mechanics lien waiver clause and the pay-if-paid clause unenforceable; the Supreme Court disagreed.

Mechanics Lien Waivers Must Be Reviewed on a Case-By-Case Basis

The project owner's argument was the mechanics lien waiver provision did not violate Nevada public policy and therefore the trial court was in error. The Supreme Court, noting that the Nevada Legislature had made contractual mechanics lien waivers void and unenforceable in 2003, disagreed and held



that trial courts must review each mechanics lien waiver on a case-by-case basis to determine whether the waiver violates public policy. The Court reasoned that:

A contractor has a statutory right to a mechanics lien for the unpaid balance of the price agreed upon for labor, materials and equipment furnished. 'The object of the lien statutes is to secure payment to those who perform labor or furnish material to improve the property of the owner.' This court has held on numerous occasions 'that the mechanics lien statutes are remedial in character and should be liberally construed....'

Underlying the policy of preserving laws that provide contractors secured payment for their work and materials is the notion that contractors are generally in a vulnerable position because they extend large blocks of credit; invest significant time, labor, and materials into a project; and have any number of workers vitally depend upon them for eventual payment....

[W]e now ... conclude that it is appropriate for the district court to engage in a public policy analysis particular to each lien waiver provision that the court is asked to enforce. In doing so, we emphasize that not every lien waiver provision violates public policy. The enforceability of each lien waiver clause must be resolved on a case-by-case basis by considering whether the form of the lien waiver clause violates Nevada's public policy to secure payment for contractors.

In this case, the lien waiver provision applies regardless of whether [the subcontractor] received any payment. We conclude that such a provision violates public policy, as it fails to secure payment for [the subcontractor].

Lehrer, supra, 124 Nev.Adv.Op. at 15-17.

This analysis is problematic for higher-tiered contractors and owners for several reasons. First, by creating a "public policy to secure payment for contractors," the Nevada Supreme Court seems to have created significant barriers to challenge a mechanics lien's validity for technical errors or omissions in the mechanics lien statutory scheme. This would seem to violate the Nevada Legislature's directive that "Except as otherwise provided in NRS 108.221 to 108.246, inclusive, a person may not waive or modify a right, obligation or liability set forth in the provisions of NRS 108.221 to 108.246, inclusive." NRS 108.2453(1). If there is a public policy to secure payment for contractors, does the failure of the contractor to serve the mandatory "Notice to Owner of Right to Lien" under NRS 108.245 violate public policy, rendering the statute unenforceable?

Second, since the effect of any mechanics lien waiver, including those set forth in NRS 108.2457(5), is to waive mechanics lien rights, can any such waiver given without corresponding payment be valid? Current Nevada mechanics lien statutes seem to disallow such a situation (*see* NRS 108.2457(2)(a)), but even if the Legislature were to change the law to make an



unconditional waiver and release actually mean what it says, does the Court's ruling here render such laws unenforceable?

While the Nevada Legislature has created a scheme whereby contractors can secure their right to payment, it is difficult to understand when a lien waiver without an actual corresponding payment or enforceable promise to pay would ever be effective under the Court's creation of a public policy of securing payment. As such, there seems to be little value in the Court directing trial courts to perform a case-by-case analysis.

Pay-if-Paid Provisions are Unenforceable as Violating Public Policy

Having dealt with the mechanics lien waiver issue and created a new public policy to secure payment to contractors, the Nevada Supreme Court turned to the general contractor's argument that the pay-if-paid provision should have been enforceable. With no more analysis of pay-if-paid provisions than one paragraph, the Court struck them down seemingly without exception:

At the time the parties entered into the agreement and subcontract, the Legislature had not yet proclaimed pay-if-paid provisions unenforceable [fn 33: We note that in 2001, the Legislature amended NRS Chapter 624 to include the prompt payment provisions contained in NRS 624.624 through NRS 624.626, which make pay-if-paid provisions entered into subsequent to the Legislature's amendments unenforceable...], and this court had not previously addressed the

enforceability of such provisions. Because a pay-if-paid provision limits a subcontractor's ability to be paid for work already performed, such a provision impairs the subcontractor's statutory right to place a mechanic's lien on the construction project [fn 34: See Wm. R. Clarke Corp. v. Safeco Ins., 938 P.2d 372] at 376 [(Cal., 1992)] (concluding that a pay-if-paid provision 'has the same practical effect as an express waiver of [mechanics lien] rights).] As noted above, Nevada's public policy favors securing payment for labor and material contractors. Therefore, we conclude that pay-if-paid provisions are unenforceable because they violate public policy.

Lehrer, supra, 124 Nev.Adv.Op. at 18.

The Supreme Court here is just wrong. First, the Nevada Legislature *did not* proclaim pay-if-paid provisions unenforceable in NRS 624.624 through NRS 624.626. In fact, NRS 624.626(1)(b) expressly recognizes that a subcontractor may stop work "*even if the higher-tiered contractor has not been paid and the agreement contains a provision which requires the higher-tiered contractor to pay the lower-tiered subcontractor only if or when the higher-tiered contractor is paid.*" Nothing, in either the legislative history of NRS 624.624 through 624.626, or in the statutes themselves, indicate that a pay-if-paid provision is invalid. Since the Court's opinion expressly states that it was not necessary to make such a ruling to decide its case (*See Lehrer, supra*, 124 Nev.Adv.Op. at 18, fn. 33), it is difficult to understand why the Court would nevertheless make such a statement. This casual remark will



nevertheless have significant practical effect on thousands of cases and transactions throughout this state.

Second, not all pay-if-paid clauses eliminate a subcontractor's right to a mechanics lien. There is no reason in the world that a subcontractor cannot agree that a general contractor's obligation to pay the subcontractor is contingent upon the general contractor being paid by the owner, while still preserving to the subcontractor his mechanics lien rights. All that is necessary is careful drafting of the subcontract agreement. While this particular provision may have been drafted to eliminate the subcontractor's mechanics lien right, not all of them will. As such, the Court should have allowed the trial courts to conduct a public policy analysis of such provisions on a case by case basis as well.

Third, the Court's decision ignores the corresponding right of a general contractor to secure payment from the owner, and the unreasonable burden placed on that contractor to have to pay subcontractors regardless of the owner's payment. Under the Supreme Court's ruling here, the general contractor becomes a *de facto* lender to the owner for the work of improvement. Further, the opinion does not deal with the situation when a lender decides not to fund the owner of a project for the contractor's work. The lender can still foreclose on the project, rendering the general contractor's mechanics lien invalid, but requiring the general contractor to pay the subcontractor. Whether the unpaid general contractor

would have a claim for unjust enrichment against the lender has not been determined by the Nevada Supreme Court at all.

Fourth, this is not California. Nevada's mechanics lien law is substantially different than that in California. California has a mechanics lien right that is guaranteed under the state's constitution. *Cal. Const., Art. 14, § 3*. There is no such corresponding constitutional right to a mechanic's lien in Nevada. As such, the Nevada Mechanics Liens should be strictly applied according to the rules of the legislative enactment- NRS 108.221 through 108.246. While these rules may be liberally construed to effect their purpose, the Nevada Supreme Court should not merely apply California law to Nevada mechanics lien statutes. The Court's citation to the 1992 case of *William R. Clarke Corp. v. Safeco Ins.*, 938 P.2d 372 (Cal.1992), is the perfect example. Unlike Nevada's Supreme Court which concludes that "not every lien waiver provision violates public policy," this California case expressly states that any lien waiver other than those provided for by statute *does* violate California's constitutional right to a mechanics lien and is, therefore, void. The Nevada Supreme Court's analysis is therefore internally inconsistent and questionable.

Fifth, unlike California, the Nevada Supreme Court has held that even if a mechanics lien is not available, a subcontractor has a right to a claim against the owner for unjust enrichment. *Leasepartners Corp. v. Robert L. Brooks Trust*, 113 Nev. 747, 942 P.2d 182 (1997). As such, a subcontractor need



not record a lien at all, but may directly pursue the owner of a project when he has refused to pay the general contractor for the subcontractor's work *without* a mechanics lien claim. In California, no such cause of action is available. Rather the subcontractor is statutorily limited exclusively to a mechanics lien or stop notice remedy. *Cal.Civ.Code § 3264*. As such, the "public policy" in California restricting the waiver of a contractor's mechanics lien right has absolutely no corresponding analogy to Nevada's mechanics lien rights such that a "public policy" against pay-if-paid clauses should be announced without the least bit of legal analysis.

This Nevada Supreme Court decision may be correct in the context of the facts to which it applies. Unfortunately, it does not limit itself to those facts. The Court's creation of public policies which are not well thought out in the context of Nevada's mechanics lien law does not appear to be in the best interests of all Nevada contractors. Rather, it appears that the Nevada Supreme Court has determined that general contractors will continue to bear the brunt of the coming owner defaults, bankruptcies and workouts that current economic conditions show are on the construction/development horizon.



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