



Fundamentals of Discharge of Mechanic's Lien Bonds

Mechanic's lien laws provide protection to contractors, subcontractors and suppliers by providing a remedy in the event of nonpayment for services or materials provided on a private project. When a lien is placed on a property, it creates an encumbrance on the title, which can negatively impact efforts to sell, refinance or transfer ownership. Mechanic's lien bonds¹ can be valuable tools for both contractors and owners to help resolve disputes while removing the encumbrance on the property. This article explores mechanic's lien bonds, their function and their utility to the various stakeholders involved in payment disputes.

OVERVIEW OF MECHANIC'S LIEN BONDS

A mechanic's lien bond serves as a legal instrument that essentially replaces the lien on the property with a bond that is backed by the creditworthiness of the surety issuing it. This is sometimes referred to as "bonding off" a lien. This bond guarantees that if a lien claim is proven to be valid, the lienor can collect against the proceeds of the bond while removing the encumbrance from the property.

Because mechanic's liens can significantly impact an owner's ability to sell, refinance or transfer property, filing a lien clouds the property's title and can even affect the owner's ability to obtain loans or secure financing. For this reason, owners often seek prompt removal of mechanic's liens.

The lien bond serves as security for the claimant. The amount of the bond is often based on the lien's value, plus an additional percentage, usually between 10% to 50%, to cover potential legal fees, interest and other associated expenses in the event of a successful lien foreclosure action.

By bonding off a lien, the lien is removed from the property, making it easier for the owner to continue business operations or property transactions without complications. The lien bond allows the claimant to pursue legal action to recover the debt but does not prevent the owner from continuing activities on the property.

STATE-SPECIFIC INFORMATION

Each state has its own statutory framework regarding the timing and process for filing a lien and for filing a lawsuit to foreclose on the property or to seek recovery against the lien bond.² Once a lien has been filed, state laws often require a foreclosure lawsuit to enforce the lien within a certain time period. Contractors must understand the specific rules governing lien claims in their jurisdiction, as these rules vary widely across states and can significantly affect the outcome of a dispute. For example, certain jurisdictions require a contractor to notify a claimant that the lien has been bonded off because the claimant may need to foreclose on the lien within a certain period thereafter. Other jurisdictions require contractors to file certain notices in the county property records when work begins³ or when the project is completed to either shorten or begin the period within which a claimant must file a lien. Compliance with these filing requirements is crucial for preserving lien defenses for the contractor and its surety while ensuring that potential lien claimants provide timely notice of their claims to owners and contractors who may not be aware of a payment dispute involving lower-tier subcontractors or suppliers.

Note that deadlines for filing liens versus the timing requirements for payment under construction contracts may be different. Contractors may find that while payment is not due under its contract with the owner, they may still be required to file a lien by a particular deadline to preserve their rights.

BENEFITS OF MECHANIC'S LIEN BONDS

The primary advantage of a mechanic's lien bond is that it improves the marketability of the property by removing the encumbrance. When a lien is bonded off, the encumbrance is lifted, allowing the owner to proceed with transactions without the threat of legal action from the claimant.

Mechanic's lien bonds are particularly useful for contractors involved in payment disputes with subcontractors and suppliers. Contractors may face significant pressure from property owners to resolve a lien immediately. Obtaining a lien bond provides contractors with the time needed to investigate and resolve the dispute properly while ensuring that the property owner's interests are protected.

For contractors and subcontractors, lien bonds provide assurances that they can pursue a claim for nonpayment without risking potential default or project shutdown. The lien bond offers a pathway to pursue and potentially resolve the dispute while minimizing the impact on the project.

If there is a dispute between the owner and contractor, bonding off the lien can mitigate owner claims for damages that could flow from the lien, such as lost rental income, loan financing charges and potential increases in lending rates.

For the lien claimant, whether it be a general contractor or a subcontractor, a mechanic's lien bond ensures payment if the claim is successful, even if the bond principal becomes insolvent. By displacing the lien with a bond, the claimant can move forward with legal action to recover their payment, with the added security of knowing that the bond guarantees recovery if their claim is valid. Moreover, as a general contractor or a subcontractor with lower-tier subcontractors, the lien claimant may need to manage certain payment obligations and business relationships with lower-tier subcontractors and vendors.

PRACTICAL CONSIDERATIONS

Mechanic's lien bonds could allow claimants to recover attorneys fees and interest if they successfully foreclose on the lien. In some instances this may impact the outcome of a dispute on a project covered by a payment bond, as that bond may not permit a claimant to recover these additional costs. As an example, a payment bond may not permit recovery of attorneys fees as a type of damages available to a claimant, but a discharge of a mechanic's lien bond may allow for recovery of attorneys fees if the claimant successfully forecloses on the lien. In some instances involving protracted litigation, attorneys fees can be substantial relative to the amount of the original lien. Contractors must weigh the potential financial impact of a lien bond compared to other remedies available through payment bonds.



In some circumstances, sureties may require contractors to provide collateral, such as cash, letters of credit or other assets, when issuing a lien bond. As such, contractors with limited creditworthiness may still be able to obtain lien bonds by offering sufficient collateral that the surety can utilize to satisfy the lien if the contractor becomes insolvent. However, by

providing the surety with collateral, the contractor could be reducing its cash reserves or utilizing a portion of its available credit, thereby reducing its finances. These are all factors to be considered by a contractor when weighing the benefits of bonding off a lien as opposed to attempting to resolve the dispute in some other manner.

CONCLUSION

As discussed in this article, there are many considerations related to the use of lien bonds in resolving payment disputes in construction projects. Lien bonds provide contractors and subcontractors with a means to secure payment of disputed amounts while allowing property owners to continue operations or transactions without the burden of a lien. By understanding the role of mechanic's lien bonds and how they work, contractors can make informed decisions about how to proceed with disputes and protect their rights to payment while maintaining a positive relationship with the property owner.

¹ Each state or jurisdiction refers to these bonds by different names, but the common terminology is Discharge of Mechanic's Lien Bond or Transfer of Mechanic's Lien Bond.

² If you would like additional information on specific jurisdictional statutes, Travelers has a "State-by-State Survey on Discharge of Release of Lien Bonds" for your reference. Feel free to reach out to a member of the Travelers Surety Underwriting or Claim team to obtain a copy of the survey.

³ Such notices are sometimes referred to as a Notice of Commencement, Affidavit of Commencement or Notice of Contract.



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