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THE NEW AMENDMENTS TO THE NEW JERSEY CONSTRUCTION LIEN LAW

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The New Jersey Legislature has revised the Construction Lien Law effective as of January 5, 2011. The new Amendments substantially limit contractors and, most particularly, subcontractors' and suppliers' ability to assert meaningful liens for labor and materials provided to improve rental property, or property related to condominium or homeowner's associations. The statute also created a new mandatory set of lien forms, included in the Amendments. L.2010, c. 119, § 1 *et seq.* (eff. Jan. 5, 2011).

The Construction Lien Law, N.J.S.A.2A:44A-1 *et seq.*, as amended, is the New Jersey statute creating "mechanics liens" for private construction projects. Construction liens (formerly called "Mechanic's Liens") are a claim for payment against the property itself. If they are properly filed and not satisfied, an unpaid contractor, subcontractor or supplier can foreclose on the lien and eventually force a sheriff's sale of the property to pay the debt. The construction industry is unique; in that companies, particularly those who provide actual labor and work to a project, usually submit bills in the month *after* the work is done. If they are subcontractors, or subcontractors to subcontractors, these bills are then forwarded up through the general contractor, who submits its monthly bill to the owner. The owner, if the project is going well, will pay the general contractor's monthly requisition, and that general contractor will then distribute payments to its subcontractors and suppliers whose invoices are contained in the requisition. Those subcontractors will then pay their subcontractors out of their shares.

Typically, the owner, (and general contractor), however, will hold back a portion of the payment (called retainage) until the end of the project to ensure that the general contractor will complete and cover the costs of final work and minor corrections, if the general contractor fails to do this work. The retainage amount is also usually then applied to subcontractors. As a result of these common practices, the construction industry is unique in that a firm is expected to provide hundreds of thousands of dollars' worth of work and services, without receiving payment for over a month in the best of circumstances.

The construction lien serves as the primary line of protection for these subcontractors and suppliers. Usually, a private construction project goes forward without anyone posting a bond. While it is also possible for a contractor to file a contract action to collect for an unpaid invoice, typically that claim will lie only against the party who signed the contract. A sub-subcontractor will not usually have a contract claim several "levels" up the contract chain, and can not sue the owner or the general contractor. However, a competing policy is that an owner who has carefully reviewed its paperwork, so as to ensure that subcontractors and subcontractors

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verify that they had been paid for their prior requisitions and deliveries before releasing more money, should not have to pay for the same work twice, and the owner should not be subjected to liens greater than the work they had contracted to pay.

In 1994, the New Jersey Legislature passed a new Construction Lien Law, which sought to reform the technicalities of the old Mechanic's Lien Law and emphasized giving notice to owners of actual amounts due claimants. It also created a stringent pre-lien filing arbitration procedure for residential construction, which required the claimant to provide an initial "notice of unpaid balance" and go through a minimal, but binding "paper-only arbitration" before being allowed to file a true construction lien. Courts, however, generally interpreted the law strictly; requiring technical service of notice and formal authorization, and rejecting evidence of actual knowledge and effective knowledge. The recent Amendments to the Construction Lien Law provides greater clarity on how to file and serve a lien, but also continue and codify the judicial imposition of strict technical conformity. The new law makes a policy decision to favor owners, particularly landlords and condominium associations which have legal title to the property, but are not the parties contracting for the improvements.

Lien Rights and New Tiering of Claimants

A key part of the amended Construction Lien Law is defining which project participants are entitled to file a construction lien. As in prior versions of the law, those eligible to file liens are: a general contractor, meaning one who was given a written contract (including a signed purchase order) by the person commissioning the project, a subcontractor or supplier to a general contractor, and a sub-subcontractor.

Because the lien law now emphasizes tiers (contractor, subcontractor, sub-subcontractor), suppliers to suppliers may now file liens. A supplier to a supplier who falls within the first three tiers of the contracting chain and has a written contract, may now file a lien under the amended law - even if the supplier does not have a "formal contract." Delivery or order slips that refer to the project site and are signed by the owner or its authorized agent are sufficient. However, as discussed below, the statute also formally defines these groups into first, second and third tier claimants, and the claimants' ability to recover may be limited according to what tier they are in.

The term "contract" is defined as a written contract, signed by the person or company (or authorized agent of the person or company) who is in direct privity with the lien claimant.[1] The phrase "authorized agent" is not clearly defined, and one issue which is likely to arise is the extent to which project managers, construction managers or architects have the apparent authority to order extra work. On larger projects, there may be contractual language on this point, but even within the carefully drawn AIA general conditions, there are circumstances in which a contractor may receive a directive to carry out certain work, short of a formal change order executed by the owner, and arguments can be made that such directives would constitute contractual work, even if no formal amendment or change order is signed. The term contract also includes amendments, both additive and deductive. For the first time, the statutory language states that a lien can include the value of retainage.

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The new law also incorporates what was previously a concept developed by judges, however: that the total value of liens can only be enforced against the amount of a "lien fund."[2] The lien fund is defined as the "earned amount of the contract," which in turn is the contract price or the portion of the contract properly completed.[3] However, the "contract fund" will vary. For a first tier contractor, (*i.e.*, a general contractor, direct supplier to the owner, or co-prime), the lien fund will equal the total value of their claims. If this is less than the lien fund available, then the amount is reduced *pro rata*. (It is unclear under what circumstances the valid amount of liens arising from direct contracts with an owner would be greater than the contractual payments due from the owner). The second and third tier claimants, however, can only partake in the amount of the lien fund due to the contractor in the level above them.[4] This tiering resolves the problem that an owner would face double liens, if its general contractor filed a lien which included an invoice for materials delivered by a supplier and the supplier filed a separate lien for the unpaid invoice. On the other hand, it hinders the subcontractor's ability to recover, subject to the contractual performance of the general contractor and prices of the contractor, and the third tier contractor's rights are derivative of the second tier subcontractor who hired him. This reduces the power of a lien claimant to obtain payment, even if the tier above him is found to have breached unrelated contract provisions.

The Revival of the Notice of Unpaid Balance Concept and Priority of Contractor Claims

Under the Amendments, a contractor can obtain priority for his lien over future mortgage disbursements by filing a "Notice of Unpaid Balance and Right to File Lien."[5] ("Notice of Unpaid Balance"). The Notice of Unpaid Balance requires a listing of the contract, amount of work done so far, the date payment was due and the amount of the payment, as well as other data. The Notice of Unpaid Balance constitutes a public filing of amounts due and that the claimant may file a lien. However, unlike an actual lien, the Notice does not have to be served, and it may be amended as more work is done or partial payment is received. The Notice of Unpaid Balance will serve to create priority over subsequent mortgage disbursements or transfer of the property, if an actual lien is subsequently filed.[6] If no subsequent lien is filed, the Notice of Unpaid Balance expires after 90 days.

Even if a claimant has not filed a Notice of Unpaid Balance, the Amendments provide lien claimants some opportunity to take priority over mortgage disbursements. As under the previous statute, a pre-existing mortgage and pre-lien mortgage payments take priority over a construction lien. However, the Amendments clarify and impose more stringent tests to establish that when a bank disburses additional advances on a loan after the filing of a lien, those subsequent advances only have priority to the extent the funds are actually used for purchase, improvement, or tax and insurance on the property.[7]

New Filing and Service Provisions

The Amendments make a number of changes to the ways in which a lien should be filed and served. The statute creates new lien forms, which should be used as of this date forward. The Amendment also draws a distinction between a claimant's submission of the lien to the county clerk (called "Lodging"), and the clerk's subsequent filing in the lien in the appropriate county book of records.[8] To file a lien, the claimant is to "lodge" it by delivering it to the County Clerk and obtaining a seal indicating the date and time of its submission.[9] The claimant then has ten days to serve the lien on the property owner, landlord, condominium or homeowners' association. However, there is a danger in waiting for the full ten days. If the County Clerk delays formally filing the lien in the books, then the

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lien will only be effective as to those who have actual "notice" that it has been lodged.[10] Service should be in accordance with the Court Rules (generally meaning hand delivery to the person's home or business address, or a corporation's official registered address), or by simultaneous ordinary mail, certified mail or over night courier.[11] The Amendments also define the circumstances under which a party may amend a lien claim, which includes adding additional work performed to adjust for partial payment.[12]

The filing of a Notice of Unpaid Balance does not extend the time for filing a formal lien. On non-residential projects, this deadline remains 90 days of last non-warranty work done or final materials delivered. However, one of the unique provisions of New Jersey lien law is that before filing a lien against residential property, the claimant first has to institute a "paper" arbitration to determine his right to lien. The Amendments preserve this system, but have provided a greater amount of time in which to accomplish this task. First, the Amendments have clarified the definition of residential construction; the term now includes any residential unit, improvements, the construction and improvement of infrastructure, including off-site infra structure required for a development which includes residential units, and the common elements of a planned development which includes residential units. The construction or improvement of a commercial unit within a development, however, is not residential construction. Nor is the construction or improvement of a unit which is "designed" only for rental.[13]

Under the Amendments, before filing a lien on "residential construction," the claimant must lodge a Notice of Unpaid Balance within 60 days, of last work. Within ten days after that, the Claimant must formally serve the Notice of Unpaid Balance and a demand for arbitration. Unless a different arbitration proceeding is specified in the contract, the Demand for Arbitration must be to a special expedited proceeding with the American Arbitration Association ("AAA"). The AAA is now to provide a single arbitrator, whenever possible, for all arbitrations from the same construction project, and either party is entitled to demand the arbitrations arising from the projects be consolidated. The Arbitrator has 30 days to render a decision, which must now include the earned amount of the first tier contractor and set offs. Either party may then seek a summary hearing before the Court. If not, the lien claimant, (assuming the arbitrator found some amount in his favor), must then lodge its lien within 10 days in that amount.[14] This entire process, however, must be completed within 120 days (an increase of thirty days from the prior law).[15]

New Provisions for Contracts on Rental Properties, Condominium Units and Units in Homeowners Association Projects

The Amendments also "clarify" and ultimately limit the usefulness of a lien claim for work which is part of a development or is on rental property. In the case of work on a condominium, in a co-op or in a development which has a community association, a contract with the association, co-op board or condominium will only give rise to a lien against that entity. A lien claim against a community association will not be deemed as attaching to any real property; rendering its enforceability or real usefulness questionable.[16] A construction manager's contract with such association is recognized as a contract within the lien laws;[17] raising the possibility that such construction manager will be deemed the "first tier" and subjecting the actual contracting firm to a subcontractor status and all that contracting firm's suppliers and subcontractors to third tier status.

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A contract with a condominium association or co-op board for work entirely within the common elements will not give rise to a lien claim against the interest of a unit owner, and a lien claim against work solely within a unit will not give rise to a claim against the association or common elements.[18] While that may sound logical and straightforward enough, in reality the liens are not that obvious. In many projects, the definition of common elements is less than obvious. The "backyards" of townhouse units, doors to apartments, exterior windows and even building systems which run through particular apartments, such as plumbing risers, may or may not be defined as common elements. Sometimes a condominium association may contract for building wide improvements which also improve each individual unit or require work within each physical unit. For instance, a shore town condominium association may decide that all windows should be upgraded to hurricane proof glass under a single cost-effective contract, even though the windows are part of each unit. Or it may decide that a common element of a fire protection system needs to be replaced, but also specify that the contractor repair or replace any damage done to an individual apartment unit's walls and decoration.

In the case of rental property, the prior statutory language specified that a landlord must approve a contract for improvements before the lien could attach to the property. Otherwise, the lien only attached to the tenant's leasehold. In the current statute, this provision has been made even tighter, so that the landlord now must have agreed in writing that its property would be subject to the lien.[19] This is in sharp contrast to the law of many other states, which tend to uphold liens, where the landlord simply had some form of notice, particularly if the work improves the value of the property, rather than a specialized fit up or decorative scheme which would be of no use, once the tenant leaves. When a lien is filed against multiple units on a residential project, then the lien may be amended as partial payment is received for each unit.[20]

The Amendment does not define landlord or tenant. Sophisticated property owners, such as national retailers, real estate investments trusts, etc., often will use complex corporate structures for their properties. They may, for instance, create a corporate shell in which they place the title of property, and then run the construction contracts through a management or operational company. Alternately, as part of a tax or financial strategy, they may "lease" property for a period of ninety or hundred years.

New Procedures to Make it Easier to Obtain Discharges of Liens

Normally, a lien may be enforced by bringing a foreclosure action within one year of the last work performed in the New Jersey Superior Court. The complaint must join all those who have an interest in the property. The lien claimant is also required to file a separate notice in the county system (called a lis pendens) providing notice to title searchers that a claim is being litigated against the ownership of the property.[21] If the lien arises from a contract which has its own arbitration proceedings, an action can be brought to meet the deadline and then stayed while the parties pursue their contractual arbitration.

The Amendments to the statute have also made it easier for someone whose property rights have been impaired by what they believe to be an improper lien or lis pendens to get it removed. When a claim has been paid, but the claimant has not discharged the lien (and 13 months has elapsed since the date of the lien claim), the owner may discharge the lien by simply submitting a discharge certificate and affidavit with prior

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notice to the claimant.[22] If a claimant fails to file the appropriate discharge certificate after an undisputed payment, any party in interest may proceed in "a summary manner" by filing an order to show cause why the lien should not be discharged.[23]

Any party may file a summary action to have the lien discharged as being factually without "factual basis."[24] This phrasing must be read in conjunction with an earlier section of the amended statute which states that if a lien, or a legally asserted defense to a lien is "without basis," then the party who wrongfully asserted it, may be liable for the others' attorney fees and damages.[25] The Amendment clarifies that "for the purposes of this section "without basis" means frivolous, false, unsupported by a contract, or made with malice or bad faith or for any improper purpose."[26] The two clauses read together suggest that a summary action to discharge the lien should only be granted when there are no possible facts to support the claim of lien rights, such as when the lien was filed without a contract, without proper signature or clearly out of time. Furthermore, such summary proceeding should not be used to exempt a lien claim where there are contractual disputes from being resolved through normal litigation or contractual arbitration procedures.

Contractor Tips

The new lien law places a premium on contractors having complete knowledge of exactly how the ownership of the property is held and the relationship of the title holder of the property to the entity awarding the contract. AIA contracts require the owner to disclose this information fully, but contractors should insist on full disclosure. If accurate block and lot numbers are given in the contract, county records on title ownership may be available on line. Whenever possible, general contractors should seek to have the title owner of the property co-sign the contract.

On projects in apartment, multi-office building or in developments of any kind, contractors should insist on complete disclosure as to what are common elements. In some cases, particularly residential work, the owner may not know this, and the contractor should inquire as to whether any approvals by the condominium association itself are necessary.

Subcontractors and suppliers are less likely to be in a position to obtain and negotiate this information, but should try to do so, to the greatest extent possible.

Traditionally, many contractors, and subcontractors have been reluctant to file liens in the middle of projects when payments are slow. Given the limits in the new lien law, they may wish to utilize the major change in their favor, the ability to file (but not serve) a Notice of Unpaid Balance and Right to File a Lien, so as to increase their possibility of ultimate recovery. When claimants do submit lien claims to the county, they should not wait for the formal indexing, but immediately serve the lien to all parties and financing entities, so they do not lose their priority. In fact, they may wish on actual notice of the filing by emailing or faxing a copy immediately.

Copies of the new lien forms, including the Construction Lien, Notice of Unpaid Balance and Right to Lien, may be obtained by emailing Sheak & Korzun, P.C. at sheakkorzun@comcast.net.

Endnotes:

1. P.L. 2010 c.119 §1, N.J.S.A. 2A:44A-2
2. P.L. 2010 c.119 §1, N.J.S.A. 2A:44A-2
3. P.L. 2010 c.119 §6, N.J.S.A. 2A:44A-9
4. P.L. 2010 c.119 §17, N.J.S.A. 2A:44A-23(c)
5. P.L. 2010 c. 119 §16, N.J.S.A. 2A:44-22(a)
6. P.L. 2010 c. 119 §14, N.J.S.A. 2A:44-20
7. P.L. 2010 c. 119 §16, N.J.S.A. 2A:44-22(a)
8. P.L. 2010 c. 119 §1, N.J.S.A. 2A:44A-2
9. P.L. 2010 c. 119 §1, N.J.S.A. 2A:44A-6b(2)
10. P.L. 2010 c. 119 §3, N.J.S.A. 2A:44
11. P.L. 2010 c. 119 §7, N.J.S.A. 2A:44A-7
12. P.L. 2010 c. 119 §8, N.J.S.A. 2A:44A-11
13. P.L. 2010 c. 119 §1, N.J.S.A. 2A:44A-2
14. P.L. 2010 c.119 §15, N.J.S.A. 2A:44A-21
15. P.L. 2010 c. 119 §3, N.J.S.A. 2A:44A-6a(2)
16. P.L. 2010 c. 119 §2, N.J.S.A. 2A:44A-3(c)
17. P.L. 2010 c.119 §1, N.J.S.A. 2A:44A-2
18. P.L. 2010 c.119 §3, N.J.S.A. 2A:44A-6
19. P.L. 2010 c.119 §3, N.J.S.A. 2A:44A-6(e)
20. P.L. 2010 c.119 §13, N.J.S.A. 2A:44-18
21. N.J.S.A. 2A:44A-19
22. P.L. 2010 c.119 §20, N.J.S.A. 2A:44-30(d)
23. P.L. 2010 c.119, §20, N.J.S.A. 2A:44-30a-b
24. P.L. 2010 c.119 §20, N.J.S.A. 2A:44-30(c)
25. P.L. 2010 c.119 §12, N.J.S.A. 2A: 44-15
26. P.L. 2010 c.119 §12, N.J.S.A. 2A:44-15(d)