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a u s e r ' s g u i d e

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i. introduction

The Construction Lien Law (Act) became effective in the spring of 1994. The Act replaced the time-worn Mechanic's Lien Law. Apart from the fact that the Mechanic's Lien Law tended to breed distrust and friction between the landowner and the lien claimant because of a required pre-filing notice, it was expensive, cumbersome and time consuming to enforce a construction lien, especially in the context of residential construction.

The Act was conceived to accommodate a number of important policy considerations. Those policies in order of importance were to: (A) secure the payment of labor, service or material provided to a construction site; (B) protect the owner of real property from frivolous or excessive lien claims; (C) streamline, simplify and update the process necessary to obtain a construction lien; and, (D) establish special rules and procedures to reduce uncertainty and delay in analyzing and resolving construction liens, especially those filed on residential property.

ii. an overview

With the exception of certain specifically defined transactions, the Act authorizes a contractor, subcontractors and suppliers of work, services, materials or equipment, as well as design professionals that have a direct contractual relationship with the landowner, to file a construction lien against the real property, subject of the construction activity.¹ The Act specifically declares that absent special circumstances, the state's public policy prohibits any efforts to require the waiver of the right to file a construction lien.

The rules and procedures that relate to the filing of a valid construction lien are well-defined, but sometimes confusing. These rules must be strictly observed, especially where the construction lien relates to residential property.

1 If the construction activity is authorized by a tenant without the written consent of the owner, the construction lien will only attach to the tenant's interest in the property, which is called the "leasehold estate".

iii. the form of the lien, its timing and notice responsibilities

The information to be recited in the lien document is specifically defined by the Act and must be verified under oath. The purpose of the verification is to insure the validity and timeliness of the lien. The lien form must be signed by the lien claimant or an appropriate officer. The signature of a lien claimant's attorney is not effective. A suggested form of a construction lien is actually found in the text of the Act. The lien document should closely follow the terms of the Act and the suggested form.

The amount of the lien is limited to the unpaid balance of the contract price for the work, services, materials or equipment. The lien may be amended, but only under a form specifically recited in the Act and where the other conditions required by the Act are satisfied, including the notice and service responsibilities recited below.

The construction lien must be filed in the county where the property is located within ninety (90) days after the date that the work, services, material or equipment, subject of the lien, were last provided. Warranty or service-call work will not extend this time constraint, nor will the furnishing of other work services, materials or equipment after the completion or termination of the underlying contract. Moreover, this deadline can not be extended, even though the contract with the lien claimant requires payment beyond this ninety (90) day time period.

Before the construction lien is filed on non-residential property, the lien claimant has the option of filing a Notice of Unpaid Balance and Right to File a Lien. (NUB).² The NUB signals to the landowner that a construction lien will soon be filed and discloses the amount of the lien. The NUB will protect the lien claimant if the property is sold, mortgaged or otherwise encumbered after the NUB is filed, but before the construction lien is filed. Otherwise, the date the construction lien is filed will control the lien claimant's priority for payment. Notably, the filing of a NUB does not affect a lien claimant's responsibility to file the construction lien within ninety (90) days after the work, service, materials or equipment were last provided. Unlike a construction lien, the claimant does not have to serve the document on anyone except a "residence," as defined by the Act. But, more of that later.

2 As explained later, the NUB must be filed in all transactions involving residential construction.

A landowner can demand that the contractor and/or all subcontractors provide a list of other potential lien claimants. The request must be in writing and responded to within ten (10) days. Similar requests can be exchanged between the contractors and sub-contractors. This section of the Act allows the landowner and others to track whether these providers have been paid or lien waivers obtained. Any party who fails to provide a complete list will be responsible for all resulting losses, including attorney fees and other costs that may result from this legislated responsibility.

Once the construction lien has been filed, a lien claimant has a responsibility to serve a copy of the lien on the landowner, the contractor, subcontractors and, sometimes, other people who may have an interest in the property. Service must be made within ten (10) days after the construction lien had been filed. The method of service must be in person, by registered or certified mail. Without proper service, the construction lien may not be enforceable. Late service, however, will not invalidate the lien unless the other party can show a “material prejudice”.

A lien can be discharged without actual payment to the lien claimant, if 110% of the true amount is deposited with the Clerk of the Superior Court in the county in which the property is located. Moreover, if a subcontractor or material supplier files a construction lien, a landowner can withhold, absent written objection, the amount of the lien and deduct the amount from the amount to be paid to the contractor under the contract.

Once the construction lien is filed, a lien claimant must commence a lawsuit to enforce it (Enforcement Action) within one year after the lien claimant last provided the work, material or equipment, subject of the lien³, or within thirty (30) days following receipt of a written notice from the landowner demanding that the lien claimant commence an Enforcement Action. The Enforcement Action must be filed in the county in which the property is located. The time periods required by this section of the Act will be strictly applied. If a construction lien is lost because of a lien claimant’s failure to file a timely Enforcement Action, subsequent lien claims can be filed, but those claims can not include any money, subject of the unenforceable lien.

In an Enforcement Action, the lien claimant has the burden of proving the factual integrity of the lien. Unlike any other litigation relating to

3 The time does not begin to run from the date the construction lien is filed.

contractual obligations, the ability to require the exchange of information and documents in an Enforcement Action is seriously limited. Also, any party having an interest in the outcome of the lien must be joined as a party in the enforcement action. In all Enforcement Actions, a lien claimant should file a lis pendens, which is another security device that will put all potentially interested parties on notice that a lawsuit has been filed against the subject property.

If the lien claimant fails to file a timely Enforcement Action and then fails or refuses to discharge the construction lien, the lien claimant will be responsible to pay court costs and attorney fees associated with any litigation brought to discharge the lien, as well as any damages sustained by the affected party. To be explained later, the same financial sanction will apply if the court determines that the construction lien was without basis, willfully overstated, or not filed in a form or manner authorized by the Act.

iv. the writing requirement

One of the central components of a valid construction lien under the Act is a contract evidenced by a writing that defines the responsibilities of the parties. (Writing Requirement). The Writing Requirement was conceived to provide an objective and reasonable factual basis to support the construction lien and thus obviate unnecessary controversy in enforcing it. It also allows others (ie. prospective purchaser, lenders, etc.) the opportunity to assess the merit of a construction lien. The Writing Requirement applies to all lien claimants who provide any work, services, materials or equipment to a construction site. The Act does not require a comprehensive contract; a collection of writings defining the terms of the agreement will do. While the Act does not appear to require this writing to be signed by the parties, in the event that a supplier uses a delivery slip, the slip must be signed by an authorized agent of the property owner, the contractor, a subcontractor or one that appears to have their authority. The delivery-slip option is not the exclusive method available to a supplier to satisfy the Writing Requirement, however.

Consistent with these general principles, courts have determined that the Writing Requirement was not complied with under the following circumstances: (A) oral contracts; (B) invoices that do not identify the construction site or the materials or work supplied; (C) unapproved change orders; and (D) an owner's application for a draw-down on a construction loan that certifies the work performed by a lien claimant, but fails to disclose

the work to be performed and how it was to be billed. On the other hand, detailed proposals and delivery tickets, along with invoices and credit applications can satisfy the Writing Requirement.

Without a document that complies with the Writing Requirement, a lien claimant may not file a valid construction lien and any attempt to do so may expose the lien claimant to various legislative penalties.

While a provider of work, service and materials at a construction site may not effectively file a construction lien, the value of the work, service or materials may be collected in a separate lawsuit based upon a breach of contract. If, however, the work, services or materials were provided in connection with a home-improvement project, and there is no written contract, the provider will suffer a whole host of other unexpected and troubling consequences.⁴

v. legislative sanctions

The Act will impose serious financial sanctions against a lien claimant who files a construction lien if it is without basis, willfully overstated and it is not timely filed or not in a form or in the manner required by the Act. Similar penalties will be imposed against a party affected by a construction lien if the court determines that the defense asserted by that party was without a factual or legal basis.

A construction lien filed “without basis” may be one that is not supported by a written contract.

A “willfully overstated” construction lien is one filed in bad faith with an intention to recover a sum of money that the lien claimant knows he/she is not entitled to. Negligence or oversight in computing the amount of the lien may not trigger sanctions under the Act; nor will a significant variance between the amount recited in the construction lien and an ultimate adjudication on the amount, if the lien claim was based on a good-faith dispute relating to the amount of the claim.

⁴ See, the author’s other book, titled: “[Walk the Chalk Line or Else: A Home Improvement Contractor’s Guide to New Jersey’s Contractor’s Registration Act and Consumer Fraud Act.](#)” You may obtain a copy of this book and other important information on these issues at www.lucianolawnj.com or call (973) 471-0004.

The time deadlines and the form of the construction lien to be used have been identified earlier in this writing.

The sanctions that can be imposed are: (A) a forfeiture of lien rights as to the money identified in the lien; (B) the cost of litigation incurred by other parties, including attorney fees; and (C) any other damages that may have resulted from the filing of the illicit lien.

vi. the lien fund

The Act generally limits the landowner's liability for a construction lien to the unpaid balance of the contract price at the time the lien is filed.⁵ Thus, if the contract between the landowner and the contractor is \$100,000 and the construction lien is filed at a time when the landowner has already paid the contractor \$90,000, the security afforded to the lien claimant is limited to \$10,000, irrespective of the amount of the lien or the number of the lien claimants.

This concept is known as the lien fund (Lien Fund). The Lien Fund's underlying purpose is to make sure that the landowner and, to some extent, contractor or subcontractors are not compelled to pay twice for any work or materials supplied to the construction site.

While it may serve a landowner well to require the contractor to obtain lien waivers from all subcontractors or suppliers as payment is made, the Lien Fund continues to protect the landowner against the prospect of double payment once the contractor has been paid for the work or materials provided to the construction site.

It is important to know, however, that a landowner's protection under the Lien Fund is limited to payments made by the landowner in good faith. If a landowner knowingly or negligently pays a contractor an advance payment before the money is due, or otherwise participates in a collusive arrangement to frustrate a lien claimant's ability to file an effective lien, the amount of money involved in the advance payment or the collusive arrangement will be disregarded when computing the Lien Fund.

⁵ Where a subcontractor files a construction lien, the landowner's liability is the unpaid balance of the subcontractor's agreement with the contractor or the unpaid balance of the contractor's agreement with the landowner, whichever is less.

Moreover, any funds retained by the landowner will be considered part of the Lien Fund, and that is so, even if the contractor has breached his contract with the landowner and the landowner wishes to use those funds to engage a successor contractor. Thus, in the hypothetical situation recited above, if the contractor bills the landowner \$90,000 on a contract with a value of \$100,000, and the landowner retains \$9,000 when he pays the contractor's invoice, the Lien Fund becomes \$19,000.

vii. residential liens and their special rules

The Act has determined that the sale, purchase and financing of residential housing is essential to the state's economic stability and that this public consideration trumps the need to preserve the interest of the people or entities who supply work and materials to construction sites with the security interests created by a construction lien. Consequently, the Act has carved out certain rules that are made to expedite the resolution of residential construction liens.

Residential property is defined under the Act as a one-or-two-family home, a condominium, a townhouse or a co-op.⁶ The Act requires "strict compliance" with these special rules before a residential construction lien can be effectively filed.

The first step of this expedited process is the filing of a NUB, which has been referenced earlier. In the context of a residential construction lien, a NUB is a mandatory component of the procedure and it must be served on the property owner. Simultaneous with the filing of a NUB, a lien claimant must serve a demand for arbitration consistent with the procedure required by the American Arbitration Association.

Once filed, the issues to be decided by the arbitrator are: (A) whether the NUB was properly filed and served; (B) whether the lien is valid and the amount of the lien; (C) whether there are any valid set-offs or counterclaims and the amount of those set-offs and counterclaims; and (D) the allocation of the arbitration costs between the parties.

⁶ A lien filed against a condominium or co-op unit is only effective against the individual unit. There appears to be a newly developing exception to this general principle, however.

If the arbitrator cannot fix the precise amount of any set-off or counterclaim, the arbitrator will order the lien claimant to post a bond, a letter of credit or other similar security devices in an amount equal to 110% of the fair and reasonable value of the set-off or counterclaim as a condition to the filing of the lien.

Consistent with the accelerated process required by the Act, the arbitrator must render a decision within 30 days after the lien claimant's demand for arbitration, unless the parties agree otherwise. Thereafter, the lien claimant will have ten (10) days to file the lien and, if necessary, post the security devices required by the arbitrator (i.e. bond, letter of credit, etc.) to assure the payment of any unliquidated set-offs or counterclaims. If the lien claimant fails to post this security and file the lien within this ten (10) day time period, the lien will be invalid.

Since the lien must be filed within ninety (90) days of the last rendering of work, material or equipment, the lien claimant's timing of the process is very important and must take into account the filing of the NUB and the demand for arbitration, as well as the procedure associated with the demand for arbitration. Therefore, the NUB and demand for arbitration should be filed sometime before the 50th day after the work, material or equipment is last provided to the construction site.

If a party to the arbitration process wishes to contest the arbitrator's ruling, a complaint can be filed with the court to vacate, modify or correct the arbitrator's decision. In addressing the issues raised by this type of case, the court must be guided by the same principles of expediency required by the Act. Notably, if a lawsuit is filed for any reason that relates to a construction lien that was subjected to the arbitration process, the arbitrator's ruling cannot be admitted into evidence.

viii. summary of event deadlines

<u>Event</u>	<u>Deadline</u>
1. Owner's Request for Verified List of potential lien claimant	Ten (10) days from receipt of written request for list.
2. Filing of the Lien	Within ninety (90) days after the date that the work, services, materials or equipment were last provided (Trigger Date), irrespective of when a NUB has been filed or ten (10) days after arbitrator's decision in a residential lien claim.
3. Service of the Lien	Ten (10) days after the construction lien is filed.
4. Interested Parties' Objection to owner's payment of amount of lien to claimant.	Twenty (20) days after receipt of the construction lien.
5. Filing of the Enforcement Action.	One year after the Trigger Date or within thirty (30) days after landowner's demand to litigate.
6. Filing of <u>lis pendens</u>	Simultaneous with the filing of the Enforcement Action.
7. Filing of the NUB	Any time after the Trigger Date. But, no later than the 50th day from the Trigger Date on residential property or within ninety (90) days of the Trigger Date on non-residential property. <u>Earlier is better.</u>
8. Service of the NUB (residential property only).	Ten (10) days after filing.
9. Arbitration Demand (residential property only)	Simultaneously with the NUB
10. Arbitrator's Decision (residential property only)	Thirty (30) days after the arbitration demand is filed.
11. Discharge of Lien	Thirty (30) days after payment or the case's resolution.

ix. conclusion

The Act provides the supplier of work, services and materials with an excellent opportunity to secure payment by way of a lien on real property. While the Act is rather efficient and effective in its terms, there are a number of pitfalls that can seriously impede your ability to obtain a valid construction lien. If you have any questions or concerns about the process, consult an attorney who is experienced in this area of the law as soon as possible, because a delay in decision-making can deprive you of the opportunity to take advantage of the Act. While you may think that you do not need an additional expense, especially in today's troubling economy, good business sense requires this financial commitment. Besides, once you have followed your attorney's directions and advice regarding the proper procedure one or two times and he/she has answered all of your questions and concerns, you will be able to develop your own procedural system for future transactions.

about the author

As a young man Frank T. Luciano, Esq. began his legal career representing a municipal planning board. Since that time, which is over 30 years ago, he has regularly appeared before planning and zoning boards representing land developers. He has established longstanding relationships with people and companies in the construction industry who have engaged him to litigate various construction claims that exceeded millions of dollars and involved numerous litigants.

His list of construction clients includes people and entities who build shopping malls, warehouses, condominium complexes and multi-million dollar homes. He also represents contractors who work in the home improvement industry, including a multi-million dollar manufacturer of home improvement products.

He is dedicated to maintaining the integrity of the American Civil Justice System by vigorously and intelligently testing principle of law and procedure that some lawyers may think to be too well-settled to question.

He is a member of the Builders & Remodelers Association of Northern New Jersey and the New Jersey Business & Industry Association. He is also a member of American Association for Justice, formerly the American Trial Lawyers Association and the Construction Section of New Jersey's State Bar Association.

While most of his work is concentrated in the northern section of the state, his practice has taken him as far south as Ocean and Monmouth Counties.

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