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BANKRUPTCY LAW

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Recent Ruling Declares No 'Relation Back'

It's difficult to reconcile *Garden State Paper* with the stated purpose of the New Jersey Construction Lien Law

Since the enactment of the New Jersey Construction Lien Law in April of 1994 replacing the old New Jersey Mechanic's Lien Law, there have been no reported bankruptcy decisions deciding whether the post-petition filing of a construction lien claim against a debtor-project owner's property pursuant to the construction lien law relates back to some pre-bankruptcy filing event or time, enabling the lien claim to become perfected post-petition within the parameters of 11 U.S.C. §546(b) — until now.

The U.S. Bankruptcy Court for the Southern District of New York has rendered a published opinion regarding this issue, holding that under the New Jersey Construction Lien Law, the construction liens that a contractor filed post-petition for its work conducted prepetition on the debtor's construction project did not relate back to some prepetition event, thus ren-

Walczyk, a partner at Wasserman, Jurista & Stolz of Millburn, is a master of the Bankruptcy Inns of Court. Callahan, a partner at Clancy, Callahan & Smith of Roseland, participated in the drafting of the New Jersey Construction Lien Law. Walczyk and Callahan argued the case for relation back on behalf of the plaintiff in Schoonover Electric Co. v. Enron Corp. and Garden State Paper Co., discussed herein.

dering the construction lien invalid. *Schoonover Electric Co. v. Enron Corp. and Garden State Paper Co., LLC (In re Enron Corp. et als.)*, 2003 WL 21435524 (Bankr. S.D.N.Y. June 23, 2003).

While the decision does not bind New Jersey Bankruptcy Courts, it does point out significant problems in the New Jersey Construction Lien Law relative to these relation back issues.

The Case

The matter was decided on competing motions for summary judgment and the facts were undisputed. Work was performed by the plaintiff subcontractor on the Garden State Paper facility within approximately 120 days of Garden State Paper's bankruptcy filing on Dec. 17, 2001. On the following day, the subcontractor filed construction liens totaling in excess of \$448,000 for unpaid services rendered.

The subcontractor then sought to establish and enforce its lien claim against the liquidated assets of the Garden State Paper bankruptcy estate. In doing so, the subcontractor argued that, pursuant to the provisions of 11 U.S.C. §546(b)(1)(A) of the Bankruptcy Code, the post-petition lien filing of the bankruptcy petition does not prevent the holder of an interest in the property — in this case the subcontractor

— from perfecting its interest if, after the bankruptcy filing, the interest holder could have perfected its interest against an entity acquiring rights in the property before the date of perfection.

In essence, for the post-petition construction lien filing to be effective, it had to relate back to some prepetition period or event; otherwise, the trustee or debtor-in-possession in this case would become an intervening lien creditor under §544(a) of the code upon the date of the bankruptcy filing, enabling the trustee or debtor-in-possession to avoid all subsequently filed liens.

In arguing in favor of relation back, the plaintiff asserted that the post-petition filing of its liens related back to the date upon which the subcontractor first provided work, services and materials to the debtor, asserting that the subcontractor's interest in the property first accrued at that time.

In examining the plain meaning of the New Jersey Construction Lien Law — and even when giving weight to the remedial purpose of the law to protect a contractor's ability to receive consideration for services rendered — the Bankruptcy Court for the Southern District of New York found that, even though §3 of lien law provides that a subcontractor is entitled to a lien for work or services performed, the lien does not attach until the lien claim is filed pursuant to §10 of the lien law. See N.J.S.A. 2A:44A-3, 44A-10.

The Bankruptcy Court went on to state that the only provision in the lien law that could potentially provide for relation back was §20, which specifies that, in the

event that a notice of unpaid balance and right to file lien ("NUB") is filed, a subsequently filed construction lien claim would relate back to the filing of the NUB, thus enabling the construction lien claimant to obtain priority over intervening bona fide purchasers and lienors.

Literal Reading

While the New Jersey Construction Lien Law intended to do away with the pre-filing requirements such as the old "notice of intention" filing prerequisite under the old Mechanic's Lien Law, the Bankruptcy Court determined that because the New Jersey Construction Lien Law stated that a NUB filing was the only way for a subsequent lien holder to acquire priority over intervening lien creditors, no subsequent construction lien could relate back in the absence of the filing of a NUB.

Under the lien statute, the only time when a NUB must be filed is when a claimant intends to file a lien against residential construction; in that case only is the NUB filing a prerequisite to the filing of the lien. See Peckar, 41 *New Jersey Practice Series: Construction Law* §12.52 (West 1998).

However, the Bankruptcy Court's decision essentially turns the NUB filing into a requirement for relation back in the event that the subcontractor's construction lien was filed, knowingly or not, after the debtor's bankruptcy filing date. The Bankruptcy Court stated that had the plaintiff filed a NUB, the Construction Lien Law would have allowed such liens to attach to the debtor's property prior to the bankruptcy filing date.

Having determined that the post-petition lien filing would not relate back to the date of the subcontractors commence-

ment of work without a NUB filing, the court then considered the plaintiff's alternate theory that the post-petition liens related back to the date of the filing of the first construction lien against the debtor roughly two-and-a-half weeks prior to the debtor's bankruptcy filing.

The filing of the first construction lien by a subcontractor of the debtor creates what is known as a "lien fund" pursuant to §10 of the Construction Lien Law. Because the date of the creation of the lien fund — that is, the date of the filing of the first lien — is the seminal event that creates the property interest to which all subsequently filed construction liens attach, the plaintiff argued that later filings should relate back to that date of the initial lien filing.

The Bankruptcy Court disagreed, ruling that the purpose of the lien fund was to effectively limit an owner's maximum liability to contractors, subcontractors and suppliers by creating a pool from which payments for work or services relating to a contract shall be distributed, and that such rationale had nothing to do with the relation back of lien claims to the filing date of the initial lien that established the lien fund.

Catch-22

Garden State Paper creates some pragmatic difficulties for subcontractors in attempting to collect for unpaid work performed on New Jersey construction projects because it essentially turns the filing of a NUB from a purely discretionary act into a mandatory prerequisite for purposes of relation back in the event of a subsequent bankruptcy filing by the debtor. Without such a filing, the subcontractor will find himself to be a general unsecured creditor if its construction lien

is not filed before the debtor's ultimate bankruptcy filing.

The practical difficulty is that there may be many instances when, in fact, it is not possible to file a NUB. This occurs when, at that specific moment, there are no monies actually due and owing under the provisions of the contract. The basic NUB form requires that there be monies currently due and owing.

Some states have addressed this issue. Florida mandates that a notice of commencement be filed for all construction projects and then provides that subsequently filed liens relate back to the date of the notice. See Florida Statutes, §713.04, §713.07(1).

Similarly, in *Yobe Elec., Inc. v. Graybar Elec. Co., Inc.*, 728 F.2d 207 (3d Cir. 1984), in a per curiam decision, the Third U.S. Circuit Court of Appeals affirmed the finding of the Bankruptcy Court that under Pennsylvania Law — which provided that the mechanic's lien relates back to the installation of the first material which predated the bankruptcy filing date — the filing of the mechanic's lien was not precluded by the automatic stay. In the case of the erection or construction of an improvement, Pennsylvania, in fact, provides that the lien of the claim filed under the Pennsylvania Lien Law is, "as of the date of the visible commencement upon the ground of the work of erecting or constructing the improvement."

Garden State Paper creates a problem that the Legislature must reconcile with the stated purpose of the Construction Lien Law — to provide lien rights to contractors who provide services and materials to construction projects and to simplify the lien filing process and eliminate pre-filing requirements for subcontractors. ■