Welcome to our latest 2019 Edition of our pamphlet entitled "*Mechanic's Liens What's It all About.*"

Welcome also to our new offices.

We have moved to expanded facilities and our new location is 200 Garden City Plaza, Garden City, New York. All facilities are same as they have been in the past. Telephone and fax numbers, emails, etc. are all exactly the same.

Welcome also to our expanded services.

First and foremost, we are now equipped to arrange for large and small construction loans, long-term mortgages, short-term financing, bridge loans, etc. -- all under the proper circumstances and anywhere in the country. We can arrange for construction financing and assist in funding.

Welcome also to our expanded Elder Law Department. We are equipped to service your Estate Planning, Wills, Estate Distribution and, yes, Will contest.

Finally, we have expanded our negligence department to service accident cases, construction injuries and other forms of damages arising from negligence.

If you are in the neighborhood, drop in to see us and have a drink (one drink only!) and say hello.

MECHANIC'S LIENS - WHAT'S IT ALL ABOUT

Fifth Edition

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In Memoriam

This pamphlet is dedicated to the memories of Eli Fishbein and his precious wife, Myrna Fishbein, two of the most devoted and cherished friends anyone could ever hope to have. May their souls rest in peace.

Parties To Whom This Pamphlet Is Addressed

Although this pamphlet might appear to be addressed to contractors and subcontractors, the fact is that all people involved in construction, as the owner, general contractor, construction manager, bonding company, insurance broker, subcontractor or material men, must be familiar with their rights, interests and obligations in the construction field. This pamphlet is intended to address the salient issues that could appear at any time. It is incumbent upon an owner to know what his rights and obligations are, just as it is incumbent upon a contractor to know when he can or cannot file a lien, when he can or cannot make a claim, etc.

Disclaimer

The Lien Law changes all the time. This pamphlet is written on the basis of the law as we understand it to exist at the time that it is written. Updates are found in monthly statements issued by our office and circulated to various associations, clients and those who ask for them.

This pamphlet is not to be construed as offering legal advice or solicitation of any kind and is not intended, nor should it be construed as an in depth recitation of the law that will apply to every particular situation under every particular circumstance. The reader is advised to consult counsel of his/her choice and not to use this pamphlet as a legal opinion or direction for a particular problem or a particular proceeding or for legal advice. This pamphlet is intended solely to give the construction public a broad and general understanding of what mechanic's liens are all about and to help them make informed determinations. We strongly recommend consultation with legal counsel of your choice to cover particular situations.

A History of the Lien Law

In the United States, we have two types of laws. We have laws that followed us through from England into the Colonies and ultimately to where we are today. This old British-type law is called the Common Law. Within the category of the Common Law are such basic tenets as landlord and tenant relationships, contract law, buying and selling, family law, etc.

To meet the needs of a changing community, the Legislature would pass certain laws. These laws are called Statutory Laws. Thus, even though there was a landlord and tenant relationship at the Common Law, we have today in New York what we call summary proceedings. This means that a landlord could evict a tenant summarily on about five days' notice, etc. This is a Statutory Law.

The distinction between Statutory Law and Common Law is that where a statute gives you certain rights, compliance with the statute must be strict. Thus, in a summary proceeding to evict a tenant, for example, every "i" must be dotted and every "t" must be crossed. If there are defects in the petition or notice of petition, etc., the case could have jurisdictional defects and be thrown out on what is called technicalities. Actually, it is strict compliance with the statute. The Lien Law is statutory law in derogation of the Common Law and must be strictly construed. If you do not dot your "i's" and cross your "t's," your lien may fail, be dismissed or challenged successfully.

A Word Of Advice

If the reader goes no further than this page, he/she must recognize the two pillars of any successful construction litigation: (1) know your contract and (2) keep accurate and complete records. Know your contract thoroughly and completely. This may be easier said than done, but if you do not know the contract you could very well be doomed. Moreover, you must maintain accurate and complete records. Just as the expression in the real estate industry is - "location, location, location" - in construction the saying is - "records, records and records". Without records you may very well have nothing.

Modern Psychic

Those who have grown up in the 1930's and 1940's and even in the 1950's were taught moral, ethical and living standards that provided for a psychological and financial concept that when you go into a store to buy something, you have to have the money in your pocket to pay for it.

Even in the depths of the Depression that followed the crash in 1929, the concept was that when you bought something you paid for it. Whoever thought of walking into a store to buy a toy without having sufficient money to pay for it?

Today, the "business mind" and psychic quite often follows the path of saying "how can I get something without paying for it?". We have a "me, me, me" attitude which infringes on the moral and ethical responsibilities in business. With

all of the scandals and scams that have hit us in the last number of years, it is no wonder that people have this selfish attitude of sponging from others. It goes without saying that we have to be alert.

Records

The most important single aspect of enforcing a mechanic's lien is records. It cannot be overemphasized. Records are the vital backbone behind all lien foreclosure actions.

You must have available to you the contract, or if there is no contract, time sheets, payroll records, material bills, labor bills and every conceivable record that might be required to support your claim or to defend the claim. A shopping bag full of notes on the back of cigarette packages, matchbooks, used envelopes, scrap papers, etc., could potentially be used, but the weight that would be given to such "records" is what you can expect from a bag full of garbage.

Logical, systematic, carefully maintained books and records have no substitute in foreclosure actions. Sometimes this is the difference between making and breaking a case.

What is a Mechanic's Lien?

A mechanic's lien gives a party certain rights and obligations against another party with whom he may not be in any type of contractual relationship and may not even know.

In Common Law, if Mr. Jones entered into a contract with Mr. Smith, they knew exactly where they stood, knew what they owed each other and agreed to an arrangement based upon a meeting of the minds. This is very simple, basic and logical.

With regard to a mechanic's lien, however, a third party is injected into the agreement and he may not have any agreement at all with one of those parties. They may not even know each other.

An owner has a contract with a general contractor to construct or renovate a building. The owner knows what he owes and what he is supposed to get. The general contractor knows what he owes the owner and what he can expect to get in return. Any ambiguities are of their own making.

They made the contract and they must live with it. They know each other or at least knew each other at the time that the contract was made and they knew who they were dealing with, or, at least could have found out. If anything goes wrong, they have only themselves to blame for not sufficiently investigating the other side.

What the Lien Law does is inject the subcontractor into this equation. If the subcontractor does not get paid from the general contractor with whom he has an agreement, then he can collect from the owner with whom he has no agreement. This is like bending the elbow against the joint.

Why should an owner be forced to pay a bill to a subcontractor with whom he has no contract whatsoever and who in many instances he might not even know? Similarly, why should a subcontractor be able to jump over a general contractor and file an encumbrance equal to a mortgage against an owner with whom he has no contract simply because he has not gotten paid from a general contractor who has no interest in the real property in the first place?

Think about that. A total stranger comes on to a man's property, slaps a lien on it and has him locked up in the same way as if he, the owner, had borrowed money and put a mortgage on it. Do not let the severity or power of that lien escape you.

The answer is that the Lien Law charges the owner with a responsibility to pay a subcontractor whose labor and materials are being used to enhance the value of the owner's property, but only to the extent of any balance due the general contractor. An owner cannot be held to pay more than his contract price.

Actually, the owner and the subcontractor are united in interest since the owner's property is being improved by the subcontractor. Even though the owner is a stranger to any contractual relationship between the general contractor and the subcontractor, the owner is the beneficiary of the contract and, therefore, has certain responsibilities and involvement.

Therein lies the beauty and the power of a mechanic's lien. It gives a subcontractor, who has no written contract with an owner, the right to encumber the owner's property simply because the subcontractor was putting labor and material into the owner's property.

A mechanic's lien carries with it very substantial power on the part of the subcontractor. It is like a bank mortgage, and an unfriendly one at that. It is a charge against the property. As long as the lien is on the property, the owner cannot sell it, cannot mortgage it, cannot get an advance on a building loan, and is effectively stymied in moving the property as if he had a mortgage on it. This is very powerful stuff.

Similarly, it carries with it heavy responsibilities on the part of the subcontractor. He cannot, for example, exaggerate the lien, file it except as provided under the statute, keep it on after it has been paid, etc., because if he abuses his rights under the Lien Law, the penalties are very severe.

In one instance a lien was filed for approximately $130,000, while the claim was knowingly for only about $20,000. The exaggerated lien effectively destroyed the financing. The lienor was in very deep trouble.

The point is that a mechanic's lien is a very powerful weapon, but like all powerful weapons, it carries with it the responsibility to use it properly and not to abuse it. Used properly, the user need have no fears. He can usually succeed under proper circumstances.

In the case of a subcontractor, the most that the owner can be charged with is the amount of his contract with the general contractor. A subcontractor cannot collect more than what is owed to the general contractor. If an owner has a contract with the general contractor for $100,000 and paid $90,000, the fund to satisfy any mechanic's liens would be $10,000. If the subcontractor is owed $30,000, the most he can get from the owner is $10,000.

If there is more than one lien, all the lienors share pro rata. If the owner owes a balance of $10,000, and there are three subcontractors who are owed $10,000 each, all three subcontractors would share the $10,000 so they would each wind up with one-third of his claim from the owner.

This becomes important where a number of subcontractors file liens. If there is a shortage of money available from the owner to the general contractor, then each lienor must look to his other lienholders to see if their liens are defective. If they can knock out a lien, then the proportion each remaining lienholder receives out of the fund, increases. It is important for a lienor not only to look to the general contractor and/or the owner, but to the co-lienors as well.

All mechanic's lienors are equal. There is no time distinction or trade distinction. A carpenter, electrician, plumber and material man are all equal and entitled to share on a pro rata basis whatever balance is running from the owner to the general contractor. The time within which liens are filed does not give one a priority over another. All are equal.

This is not to say that the subcontractor cannot collect the balance from the general contractor. The general contractor is contractually responsible to the subcontractor for the full amount, but gets credit for whatever the subcontractor gets from the owner.

Moreover, this does not apply to a case where the owner is also the contractor. If an owner decides to be his own general contractor, the contract price is not a limitation of lien rights as against his own subcontractor. It would be a limitation as to the general contractor's subcontractor's, but not as to the subcontractor's claim in a direct contract with the owner-contractor.

These are just some of the stringent requirements that apply in the filing and foreclosure of the mechanic's lien. There are others. Some rules are more stringent than others, but the general idea is that since this in derogation of the Common Law, strict compliance with the statute is mandated in order to gain the benefits of that statute.

Types of Mechanic's Liens

There are two types of mechanic's liens. One is a private improvement lien that applies to private construction and renovation, and the second is a public improvement lien that applies to public improvements. The two are not the same. They have overlapping provisions, and requirements, but essentially they are different.

In some instances, the distinction becomes cloudy as when the government will buy a private piece of property for the purposes of improvement in a turn-key project, or where the government will lease property for private improvement. Those complications will not be discussed, but the distinction between the public improvement and the private improvement will be examined.

Time Within Which To File A Private Improvement Lien

Years ago a mechanic's lien had to be filed within four months after the last item of work or material was delivered to the job site. An amendment raised the time from four months to eight months except in one-family houses where it is still four months. Many contractors and subcontractors breathed a sigh of relief at the additional four months. Many learned to their dismay that they should not have been so happy. This amendment created a type of laxity on the part of the subcontractors. They figured that if they have eight months in which to file the lien, they are in control of the situation. This change turned out to be somewhat of a misplaced sense of security because a mechanic's lien attachs to the balance owed by the owner to the general contractor.

Within that eight-month period, the owner who is not aware of any unpaid bills, could and often does pay the general contractor and the general contractor takes off. Without any money running from the owner to the general contractor, the subcontractor who sat on his rights, loses out. What would ordinarily be a valid lien now becomes a dispute between an owner who has paid the contractor and a subcontractor who has not been paid at all.

Subcontractors would be wise to watch the situation carefully. If it becomes apparent that the general contractor is playing games, is stalling, claims that payment will be forthcoming, or that "the check is in the mail", then serious consideration should be given to filing a mechanic's lien, regardless of what the time frame is. In these scenarios, the major consideration should be the integrity of the general contractor.

When Not to File a Mechanic's Lien

The initial determination to file a mechanic's lien is a business decision.

There are many instances where the filing of a lien will terminate a relationship. It is a very powerful weapon and like all powerful weapons, it has to be used wisely and for its intended purpose. It is something that is important, effective and highly technical and cannot be used indiscriminately, recklessly or irresponsibly.

Filing a mechanic's lien is a two-way street. It has its ups and it has its downs. You have to make a business decision as to whether or not you want to file a mechanic's lien and potentially antagonize a very substantial friend or customer or client, or protect your money for that immediate job. Therein lies the tightrope that you are walking in filing a mechanic's lien.

Repairs and Corrections

Repairs and corrections under a base contract cannot be used to enlarge your time for filing a mechanic's lien. This would only reward incompetent contractors or subcontractors.

Your lien time does not begin to run until the contract and all extras are completed. If a particular aspect of the job is a continuation or a fulfillment of the contract, regardless of how minute or inconsequential it might be, your lien time starts to run from the completion of that work. If, however, the work is only a repair of previously completed work, regardless of how extensive the repair may be, then the lien time starts to run from the time of completion of the contract, and not the date of the repair.

Punch lists are part of the original contract. When the punch list is completed, the lien time starts to run. Any item done on the punch list, even if the punch list is not completed, also starts the lienor's time running. In other words, if there are ten items on the punch list and you did two or three and did not do the others because of a dispute with the owner or the general contractor, your lien time starts to run when you completed the two or three items.

Lienable and Non-Lienable Items

Occasionally, an argument can be made that an item of labor and material is not lienable. This would come about if the item supplied is personal property and does not become part of the real property in the lienable sense. "Lienable sense" means the same item could be lienable under one circumstance and not lienable in another.

Generally, very specific items are not lienable. The rental of a bulldozer is not lienable; a bulldozer with an operator is lienable. Fuel oil is not lienable, but oil burner service is. Materials and tools not used or consumed in the construction of a job are not lienable. A ladder, hammer, pliers, etc., are not lienable. Nails and screws, nuts and bolts, etc., that go into the job and are used in the course of construction are lienable.

An electric fixture may or may not be lienable, depending upon the context in which it is installed. If a builder installs fixtures as part of the overall construction job, it is lienable. But, if the homeowner orders a fancy crystal chandelier, that chandelier is not lienable against the builder, but lienable against the owner.

Landscaping, where the builder has put in a certain number of shrubs, sod, etc., is lienable. But, if the owner wants to put in certain shrubbery for aesthetic purposes, etc., then it becomes non-lienable as against the builder, but lienable against the owner.

You will note that we are talking about lienable as against the builder. Where an owner bypasses a general contractor and orders the subcontractor to do work, the subcontractor has a direct lien right as against the owner and can lien against the owner. The owner becomes responsible to the contractor for what the owner ordered, and the general contractor remains responsible to the subcontractor for what the general contractor ordered. This distinction becomes relevant in one-family construction and in condominium and cooperative apartments where the orders for work become blurred as to who is issuing what order and when.

It also creates problems as to the time period within which the liens could be filed. i.e., either four months or eight months, or if at all.

Portions of your claim may be against the general contractor or builder and portions may be against the owner directly.

Private Improvement Mechanic's Lien

A mechanic's lienor has a right to file his lien, make a charge against someone's property and keep it there as long as it is not dismissed, paid, discharged or satisfied, provided that he complies with the statute.

Within one year, he must either renew the lien or institute foreclosure proceedings as if foreclosing on a mortgage. A summons and complaint must be served, the proper parties must be named and the case must go to judgment of foreclosure and to a public sale of the property at auction, etc., exactly the same as the foreclosure of a mortgage. A lien foreclosure is equivalent to a mortgage foreclosure without any contractual agreement between the lienor and the owner. Again, this is very heavy stuff.

Of course, a general contractor who is not paid by the owner can also file a mechanic's lien, but at least the general contractor has a contract with the owner.

Public Improvement Mechanic's Liens

A public improvement lien is basically the same as a private improvement lien. The difference, however, is that where there is a public job you cannot sell the real estate. If you are doing a job on a public highway, for example, you cannot take one mile of a public highway, separate it out and sell it at public auction. You cannot sell half of a public park, a police station, fire house or hospital, as the case may be. The difference is that in a public improvement, the lien attaches to the balance of the contract and not to the property.

As a result, what is attached in a public improvement mechanic's lien is the money that the governmental agency is holding for the account of the general contractor. This takes the place of what, in a private improvement lien, would be the owner's property. If there is no fund left over, i.e., the government paid out everything to the general contractor, then you are right back in the same position as if an owner in a private improvement project has paid the general contractor

in full. This means that if payment was made in full, the lien has nothing to which it can attach itself. There is no recovery, therefore, on that lien. This is not to say there are no other remedies. Some of these will be pointed out below.

As in the case of a private improvement lien, a public improvement lien attaches only to that balance which remains unpaid. If more than one lien is filed against the fund, all liens share pro rata.

The time frame for filing a public improvement lien is thirty days after completion and acceptance of the project itself. This means that as long as the project has not been completed and accepted, you can file your lien within thirty days after completion and acceptance, even if you did the work or supplied the materials two or three years earlier. The eight-month or four-month provisions of the private improvement Lien Law do not apply to a public improvement and is valid for one year and has to be renewed.

As to proof, record-keeping, etc., there is no distinction between a public and a private improvement lien.

A public improvement lien can also be discharged by bond and the failure to discharge it by bond will result in the refusal by the government to release any additional funds to the general contractor.

Simultaneously with the preparation and filing of a public improvement lien, it is recommended that every effort be made to determine whether or not a payment bond was filed with the government. Most public improvements require a payment and performance bond. If a bond covering payment was in fact filed, every effort should be made to determine that fact, the bond number, bonding company and to comply with the notice requirements, etc.

Unlike a private improvement lien, the general contractor hired directly by the governmental agency does not have the right to file a mechanic's lien on the funds being held for the project.

Rights and Obligations of the Lienor

When the law gives a party very strong and powerful weapons, it creates equally strong and powerful obligations.

In simple English, some of the rights and obligations that a lienor must comply with are as follows:

1. In a private improvement, the lien must be filed within eight months from the last day the lienor performed any work or furnished any materials unless it is a one-family house, in which case it must be filed within four months.

In our previous pamphlets and lectures, we also include a two-family house. The statute provides for only a one-family house as requiring that the lien be filed within four months. Why that was done, we do not know. Also condominiums and co-ops are deemed to be one-family houses.

In most other instances, under the law, a two-family house and a one-family house are treated together. Both are subject to similar zoning, both are usually owner/occupied, both are considered non-multiple dwellings, both require home improvement licenses, both usually involve owner-contractors and both usually involve people who are unsophisticated in the ways of construction and pay as they go along. We, therefore, urge everyone to treat a two-family house similar to the one-family house and file the lien within four months. The longer you wait, the more likely it will be that the owner has paid the general contractor, who, in turn, disappeared.

2. A lien is good for only one year after it is filed. It can be renewed for one additional year on a notice and two additional years on court orders for each additional year. As stated previously, a lienor cannot extend his lien by doing a poor job. Once the contract and all of the extras are completed, if he does not file his lien within the time frame, he loses his lien rights. If he goes back to the job for the purposes of making repairs as opposed to completion of the contract or extras, he cannot benefit from his own sloppy work, and the lien time is not renewed or extended.

3. You cannot wilfully exaggerate the lien. If the subcontractor is owed $10,000, he cannot file a lien against the property for $100,000 and say, "oops, I made a mistake."

If the lien is declared to be wilfully exaggerated, the party responsible can be held for the difference between the amount of the lien and the amount for which it should have been filed. He can also be held responsible for all kinds of damages and all sorts of expenses. This is a very serious infraction and we strongly urge everyone to avoid trying to sneak in an exaggerated lien. The ramifications are extremely serious. The lien can be declared void and substantial monetary offsets can be imposed.

Rights and Obligations of the Owner

An owner has certain rights and certain obligations just as the lienor has. Some of these are as follows:

1. The owner cannot be held responsible to pay more than his contract price;

2. He can bond the lien. By doing this, he frees up the property from the yoke of the lien. This does not change any of the responsibilities or obligations of the lienor.

The lienor must still foreclose on the lien, prove his case, establish the existence of a fund, etc., in the same fashion as if he had no bond, but now he has the security of the bond instead of the property.

The owner still has the same rights as if no bond had been filed. He can claim exaggeration of the lien payment in full, failure to comply with the statute, defects in the lien itself, etc.

Moreover, owners or general contractors try to intimidate subcontractors by saying that they have no problem with having the lien filed, because all they will do is simply bond it. It is not that simple. The bond has to be collateralized at 125% of the exposure. Thus, if you file a lien for $100,000, the bond is for $100,000, plus 9% amounting to $109,000. The bonding company, in turn, may require cash collateral for at least $125,000. Then, of course, there is the little matter of paying a premium for the bond. This premium has to be paid annually until the bond is discharged. The bond is not discharged until you get paid or there is a trial.

Anytime anyone "threatens" to let you file a lien because all he will do is "just bond it", recognize that it is a bluff and let him do just that.

3. As a corollary to bonding the lien, an owner can discharge a lien by a deposit with the County Clerk. This also frees up the property and the same rules apply here as with a bond. Unlike the bond, there is no collateral and there is no premium, but cash is locked up.

4. An owner cannot prepay the general contractor so as to wipe out or dissipate any fund that would be available to subcontractors.

If, for example, the owner has a contract with a general contractor for $100,000, the owner cannot pay the general contractor $50,000 when all the general contractor did was $10,000 worth of work so as to defeat the rights of a subcontractor and wipe out any fund. In other words, the owner cannot pre-pay so as to destroy any lienor's rights.

The reader must not be misled in this regard. If an owner puts down an initial deposit before the general contractor starts, this is not an attempt by the owner to frustrate the

lienor's rights. The lienor's rights are frustrated when the owner and the general contractor get into some type of arrangement whereby the owner pays the general contractor in advance in violation of the terms of the contract so as to defeat the lienor's rights. As long as the owner complies with the terms of the contract, even if he loads the job up front, the lienor does not have a claim for wilful dissipation of funds.

If the contract is for $100,000 and the owner is required to put up $25,000 at the start of the contract, the owner cannot be held responsible to the lienor. There has to be a violation of the terms of the contract, whereby the owner pays the general contractor $25,000 on a $5,000 requisition. Then the owner could be held responsible in a difficult piece of litigation for destroying the lienor's rights

5. The owner has a right to demand from the lienor an itemized statement of each and every item of labor or material that went into the job, the date of installation, the amount of labor involved, the cost, etc. Failure to do so could result in the dismissal of the lien. Here again we need records, records and records.

6. The owner may demand that the lienor foreclose the mechanic's lien and get the action started. This is done sometimes when the lien is small and the cost of foreclosure is great so that the owner forces the lienor's hand, or if exaggeration is suspected.

7. An owner who has not received notice of the filing of a lien has every right to pay the general contractor, even though the lien has been filed. If the owner is not served with a copy of the lien personally or by certified or registered mail, he is not on actual notice of the existence of the lien and if he pays out before he gets such notice, he is home free.

8. The owner can also wait for the lien to run its course and let the lien lapse by the expiration of one year. If the lienor is alert and renews the lien, then the owner can pursue his various other remedies, some of which were outlined above.

Tenant Improvements

A common issue of dispute is where a tenant moves into a building and makes substantial renovations and improvements. Then the tenant goes bust. What happens to the contractors?

The usual situation is that the contractors file mechanic's liens and scramble to try to get paid by the owner. This type of litigation is very difficult.

To hold an owner responsible for tenant improvements is extremely difficult. You have to show the owner became enmeshed in the construction project. If the owner gave the tenant six months' concession, approved the plans, stood with his hands in his pockets and watched the construction project go on, etc., he still is not responsible to the contractors. He has to actually physically take part in the construction, participate in it, and essentially become a general contractor, before any contractor can hold him responsible.

Moreover, the fact that the improvements will remain after the tenant has vacated or that the improvements are structural in nature, such as the installation of air-conditioning, plumbing, electrical work, etc., all of which are incorporated into and become part of the property, is of no avail to the hapless contractor. It is a gift and a bonanza to the owner.

Transfer of the Property

Occasionally, you might run into a situation where property is sold or transferred during the construction. If it is transferred fraudulently to avoid payment, there is usually not too much of a problem. The new owner has to be ferreted out and the relationship between the new "owner" and the prior owner has to be shown. Fraudulent transfers are not worth very much.

Sometimes, however, there is a bona fide sale. When that happens then certain factors and laws kick in.

If the new owner continues the construction, then the new owner becomes responsible under the Lien Law for what he orders, but not responsible for what the prior owner ordered. If the new owner owes the seller any money, a lien filed by the contractor will not necessarily compel the new owner to hold back any money. The new owner may be duty bound to release the money to the prior owner.

However, there is a provision under Section 13 of the Lien Law that creates a trust for the benefit of any labor or materialmen which applies to any money that the old owner received from this sale. Therefore, if the new owner holds any money, the trust provisions may compel them to retain the funds.

Where there is a contract, but no closing of title and no transfer yet, a Mechanic's Lien will serve the purposes of forcing the title company to hold the money in escrow.

This will protect both the owner and the contractor. The owner's liens will be covered by the escrow and the owner will still have every right to defend. The title company becomes a stakeholder and pays whoever is entitled to be paid after the litigation is concluded.

The important factor here is that even if there is a smell of the possibility of sale of the property, the lien should be filed promptly.

Defenses

The owners and general contractors usually interpose certain standard defenses. Some of them are as follows:

1. No balance due. If there is no balance due from the owner to the general contractor, i.e., the owner has paid the contract price in full, then the lien cannot stand. This defense is most common.

The honest owner is probably the most difficult party to challenge. He has good records, he is not out to fleece anybody, and he honestly paid the general contractor in full. The general contractor, in turn, took off and left the face of the earth. The best protection for the lienor is to file the lien promptly before the contractor takes off. In the absence of that, it becomes a matter of digging out all of the information through the records to see if the owner is mistaken in charging to the job items that are not properly chargeable under the circumstances.

Sometimes we have an owner looking to take advantage of an absent contractor to make a killing. These are the difficult cases, because it takes an enormous amount of digging to ferret out the falsehoods. This takes the most skill and the most time. It is a matter of digging through the records to come up with the hidden subterfuges. If handled properly, these subterfuges and devious tactics can be discovered.

Normally, the dishonest owner will fall by his own weight. The "back charges" against the absent general contractor are usually so flagrant, obvious and ridiculous, that only an arrogant wise guy would even assert them. Yet, believe it or not, this is what exists in the trade.

In one instance, for example, two brothers, in an effort to wipe out the "fund" and to show that they owed the general contractor nothing, worked up a bill of about $3,000 a week for taping and spackling. The problem is that the taper and spackler was their mother about 80 years old who did not know tape from spackle.

2. Poor workmanship will be claimed against the absent general contractor requiring completion, repairs and undoing of the work. Careful examination of the owner where there is an absent general contractor may reveal that whatever "repairs" had to be done were in fact "extras", having nothing at all to do with the base contract.

3. Willful exaggeration of the lien will be claimed. This is standard operating procedure, and is usually alleged, but rarely proven. This is based upon the lienor's records, and if the lienor's records are accurate and correct, then this defense is only a shot in the dark.

4. Failure to obtain necessary certificates, etc., is also alleged as a defense. In this instance, all you have to establish is that the necessary underwriter's certificates, certificates of occupancy, etc., have been obtained, or, in cases of building loans, that the interim installment payments were made, and this defense goes down the tubes.

5. The contractor was kicked off the job or a seven-day notice was served. This could be used sometimes by unscrupulous owners or general contractors. After the job is virtually complete, they send a "seven-day notice" telling the contractor that his work was terrible, etc. This could be a subterfuge.

6. Failure to serve and file within the time limitations a copy of the mechanic's lien. The Lien Law requires that a copy of the lien be served within thirty days and proof of service be filed within thirty-five days of filing. The proof of service must be filed within thirty-five days of the filing of the lien, not thirty-five days from the day it was served. If this is not done, the lien is void, and, therefore, the owner has a defense.

7. Where a home improvement license is required the defense that the home improvement contractor is not licensed can be invoked.

Promissory Notes

Promissory notes can vitiate and nullify lien rights. Where a promissory note is given and payment on that promissory note is beyond the lien period, you may lose your lien rights because you have replaced your lien rights with a promissory note.

Thus, if you completed the job on February 15, your lien rights start to run as of that date. You must file your mechanic's lien by October 14. If the contractor gives you promissory notes payable November 1, you may lose your right to file your mechanic's lien by October 14.

There are complications in this area and courts are divided in their decisions. This should be reviewed on a case by case basis. To be safe, if promissory notes are taken, they should not go beyond your lien time.

Written or Oral Contracts

A mechanic's lien does not have to be supported by a written contract. If there is a written contract, then you are ahead of the game. If there is an oral contract, it is just as supportive of a mechanic's lien as a written contract, but creates problems on proof.

In fact, the usual situation is written and oral combinations where there is a base contract plus oral orders for extras or change orders, as the case may be. As long as there is a contract, written or oral, then a mechanic's lien can be filed.

Time of the Essence Clauses

A very dangerous pitfall to be avoided is time of the essence clauses. Most AIA contracts make time of the essence. Stay away from them. Strike the clause.

Time of the essence means that regardless of what happens except in the most extreme instances of force majeure, the contract must be completed within a certain deadline date. If it is not, then every conceivable expense, down to a postage stamp in the office, will be charged to the contractor, and there are no excuses.

There is a major distinction between time being of the essence and complying with a construction schedule. Coordination is one thing, and time of the essence is another. The owner is entitled to coordination and to get the job done expeditiously, but a time of the essence clause is cutthroat and ruthless.

There are problems if a liquidated sum is put into the contract and there are even more problems if no such sum is put in. To go into questions of time being of the essence and all of the damages, etc., would take up too much space. Suffice it to say that time of the essence is not a healthy clause for the contractor and stay away from it.

Payments as Waivers

Once a payment is made, it often represents an acknowledgment of a job well done. The owner, after inspecting and paying the general contractor or the subcontractor, as the case may be, cannot later on say that the job was done improperly and poorly. Payment constitutes a waiver, in most instances, of any defects, provided that a proper inspection was had, and provided further that it is done after the submission of the bill.

Where contracts provide that payment does not constitute a waiver, there is a question of fact, but the lienor is in a strong position because payment would constitute a waiver of the provisions in the contract that would otherwise allow the owner to withhold payment. This becomes especially interesting where there is constant supervision and constant inspection of the work. Even though the contract says that payment is no waiver, if the lienor can establish that the owner, the bank, the architect, etc., constantly inspected the work, then the provisions in the contract saying that payment does not constitute approval, could be challenged.

Caution should be exercised. Under normal circumstances, payment can constitute acknowledgment of satisfaction in the performance. Sometimes, however, there is a tricky clause in the contract that should be watched. It will say that payment by the owner does not acknowledge satisfaction of the work, and that clause can be enforced.

The contract can also provide the reverse, i.e., that acceptance of the payment by the contractor represents acknowledgment by the contractor that payment in full has been paid. "Payment in full" may or may not mean that the entire contract was paid, but it may mean that the requisition that was submitted was paid in full and there can be no claim on that requisition (except for retainage, etc., if that is specifically spelled out in the requisition).

Accordingly, a contractor who is not alert to the provisions in the contract may find himself in a situation where the owner has not waived his rights against the contractor but at the same time, the contractor may find it difficult to recover for an inadvertent omission of an extra or an error in billing, etc. Watch out for that. Again, know your contract thoroughly.

Lien Waivers

A Mechanic's lienor cannot waive the filing of a mechanic's
lien. The statute does not permit that to happen. However, a contractor can be asked to execute a lien waiver. What is the difference?

The answer is that a contractor is not authorized or permitted to waive his right to file a lien in advance of doing the work. He cannot enter a contract that would say that he will not file a mechanic's lien. That provision in a contract is not enforceable.

However, the owner is entitled to receive a lien waiver from the contractor. That lien waiver takes place during the progress or at the end of the job, not in advance or the work. It certifies to the owner that the installment payment that the contractor is receiving is fair and reasonable and that all of the subcontractors have been paid or will be paid out of the current requisition. This also applies to the final requisition and gives the owner protection. Sometimes the owner will ask for lien waivers from the subcontractors as well. The owner is entitled to know the contractor will be paying his subs and that the subs will not be looking back to the owner for payment.

Where there is a partial lien waiver, and an installment payment is not made, the lien waiver is not worth the paper it is written on. If the owner takes the lien waiver and says "ha, ha, I have you over a barrel", that will not fly.

On the other hand, if the lien waiver is inaccurate as to the amount, or if it does not consider retainage money or the contractor does not cover all his bases and dot every "i" and cross every "t", the contractor may have a problem. Where the lien waiver says "final payment", if it is not a final payment, then the contractor will have a problem.

Just remember that you have to know your contract and keep accurate records, because lien waivers are important and they must be handled properly.

Construction Manager or General Contractor

Although construction managers have been around for many years, only in the past few years have they come into full bloom. Under ordinary circumstances an owner went out and hired a general contractor, who, in turn, hired the subcontractors and got the job done. With the appearance of a construction manager things became somewhat different.

A construction manager is the agent for the owner. Whatever he does is binding on the owner. When you have a contract with a construction manager, you have a contract with the owner. This means that if you are not paid, you have a direct action against the owner. You do not have to worry about sharing a fund or even establishing a fund running from the owner to the construction manager. You go directly against the owner on a construction manager's contract.

If you are dealing with a general contractor, you have to show that the owner owes the general contractor money in order to establish the validity of a lien. You do not have to do that with a construction manager.

If more than one lien is filed, and the owner owes the general contractor a limited amount of money, all of the lienors share pro rata in that fund. With a construction manager, that does not apply.

If you file a lien, you have to name the general contractor. You do not have to do that with a construction manager.

This sounds good, but there are major pitfalls and problems.

Sometimes you do not know if a construction manager is a construction manager or a general contractor. If you are dealing with "Jones, Inc." on behalf of an owner as a construction manager in 2008, you cannot assume that "Jones, Inc." is a construction manager for the same owner in 2009. They keep changing hats. If you are dealing with "Jones, Inc." as a construction manager for the owner on Job No. 1, he might be a general contractor for the same owner on Job No. 2 at the same time.

Sometimes a construction manager has his own general contracting company and that creates more mud in the waters and traps for the unwary. The only restriction is that he cannot be a general contractor and a construction manager at the same time on the same job.

The ramifications are very serious. It is absolutely essential that you determine whether you are dealing with a general contractor or a construction manager. It could be extremely difficult sometimes to get that distinction and the construction manager may not want to give it to you.

The only suggestion that we can give you is to stay alert and get the facts. Ask the hard questions at the time of contract and be satisfied with the answers.

Discharge Bond and Payment Bond

There is a major distinction between a discharge bond and a payment bond. A bond discharging a mechanic's lien has no effect whatsoever on the validity or the proof required to establish the lien. This is not the same as a payment bond.

In a payment bond, the general contractor certifies to the owner that he, the general contractor, will pay all labor and material bills. This has nothing at all to do with the mechanic's lien.

In order to recover under the payment bond, the labor and material man must establish that he provided the labor and material for the project and he comes within the purview of the payment bond. He does not have to establish any lien rights that there is any money due from the owner to the

general contractor, or that he filed a mechanic's lien, etc. All he has to do is show that he is a labor and material man who worked for the general contractor on the job and was not paid, although entitled to payment, and that he complied with the terms of the bond. This last item is vital, and must be complied with strictly.

There are, however, dangers. Most bonds carry with them a short Statute of Limitations of either one year or two years. They also carry with them notice provisions. This is intended to avoid any type of collusive abuse.

A subcontractor of a subcontractor might be called upon to serve notice within ninety days upon two of three individuals. The three individuals are the bonding company, the owner and the general contractor. He might have to notify two of these three parties that he did the work and has not been paid and the amount that is due when the payment became due. Then he may have one year or possibly two years to institute an action, usually within the county in which the work has been done. The claimant must strictly comply with these conditions.

Compliance with the notice provisions is absolutely essential. Failure to comply with the notice provisions could void any right under the bond.

These conditions do not usually apply to subcontractors who have a direct contract with the general contractor who has obtained the bond. Nevertheless, even the subcontractor to the general contractor has conditions that must be met in order to qualify under the bond.

In some instances, as with the New York City School Construction Authority, you may have to make a claim within ninety (90) days regardless of what the bond says.

The recommendation, therefore, is that if the job is bonded, the first thing that the subcontractor or the subcontractor of a subcontractor should do is to get a copy of the bond and make sure that all notice provisions are fully complied with in the event of a dispute. The parties to the bond are required to give you a copy on demand, but you must make a demand.

Requesting a Copy of The Payment Bond

Because of the enormous number of defaults, bonding companies have become extremely conservative and difficult. Bonding is, in many instances, a very essential aspect of a contractor's business. Sometimes even the request for a copy of the payment bond will trigger a situation where bonding could be rejected or impaired. It takes the same business decisions to demand a copy of the bond as it does to file a mechanic's lien. You must approach this matter gingerly if you want to maintain a relationship with the contractor. If you go directly to the contractor and ask him for a copy of the bond, you will be alerting him to what you have in mind. If he is honest, he will give you a copy of the bond and work a deal with you. He may even arrange to have payment made by the bonding company to avoid a claim if he is short on cash.

If you go directly to the bonding company, you could very well hurt the contractor. If you wait, you could very well be hurting yourself. This is a business decision that must be made. This is best handled when the contract is signed and the parties are friends.

Subrogation Claim

Subrogation is a legal term that permits someone to step into your shoes and make a claim against a third party in your place. This is common with insurance companies. If you have an automobile that has collision insurance and someone damages your car, your insurance company will pay for the damage, less the deductible, and make a claim against the party who caused your damage so that they can get back the money that they paid you. This is what they call "subrogation". You are not permitted to prevent subrogation. In other words, if someone hits your car, you cannot give that person a general release so as to prevent the insurance company from pursuing the claim against the party who caused your car damage. If you wipe out those subrogation rights, you become responsible to the insurance company. This becomes especially acute in a situation where the claim has to be made in your name.

Accordingly, if you have an accident and your insurance company pays you, your insurance company will have to make a claim in your name against the party who hit your car. It will not be in the name of the insurance company. Therefore, you are dutibound to make sure that those subrogation rights remain intact.

In today's day and age, insurance companies are becoming extremely difficult to deal with and extremely imaginative and energetic in disclaiming claims. They come up with all kinds of excuses and ideas and they refuse to pay.

At the same time, these insurance companies are looking out for themselves in construction contracts and absolutely and positively insist upon subrogation rights. This translates to provisions in the contract where an owner's insurance company will demand that the general contractor arrange for subrogation in the event that the owner is called upon to make payments for work arising out of the general

contractor's responsibilities. Subrogation clauses are very tricky and a general contractor can get caught in a squeeze. On the one hand, the owner will demand subrogation rights against the general contractor's insurance company and at the same time the general contractor's insurance company will balk in giving the owner subrogation rights.

In terms of contract provisions, this tug of war translates to situations where if someone gets hurt on the job and makes a claim against the general contractor and the owner, the owner will pass the buck on to the general contractor and the general contractor might want to make the claim over as against the owner. In advance of the happening of the accident and at the contract signing, the owner might demand a right of subrogation against the general contractor if any such claim is made. The waiver of subrogation, which is what it is called, is enforceable. The only time that it is actually not enforceable would be if the owner's negligence is what caused the accident.

You cannot ask somebody to pay your bill if you are negligent, but in all other instances, it can be done. Before signing a subrogation waiver, it is absolutely essential that you consult with your insurance company and your insurance broker and make sure that the insurance company consents to the waiver of subrogation. If you do not do that, you might find yourself without insurance and you never want to do that.

Moreover, do not rely solely on your insurance broker. He may be very knowledgeable and sincere, but insurance companies have been known to undermine their agents and their brokers and the best of them get caught in the untenable squeeze having the insurance companies twist and turn to justify a disclaimer. The brokers work hard for their clients and mean well. We have no problems with brokers. We have problems with the insurance companies. They slip things into the insurance policies in fine print. Watch out for that.

Know the contract and you know exactly what your subrogation rights are or are not, as the case may be.

Fees and Disbursements

In an action to foreclose on a mechanic's lien, there are special provisions for fees and disbursements. The interest rate is 9% and that becomes payable from the earliest ascertainable date that the debt became due. In addition to

interest and the usual costs and fees, there is a special provision under the law that allows additional fees and additional disbursements to be collected in the foreclosure of a mechanic's lien.

Legal fees are not recoverable unless agreed upon in advance under the terms of the contract or if some law or statute authorizes it. For example, if your contract says you are entitled to legal fees, then you can recover them. If you file an exaggerated lien and get caught doing that, you become responsible not only for the difference between the amount of your lien and the exaggerated amount, but also for the owner's legal fees.

Licenses

The issue of licenses has become a major headache in many respects. The general proposition is that if you need a license and you do not have one, you cannot collect. You cannot file a mechanic's lien, you cannot sue for breach of contract, you cannot sue for a fair and reasonable value, you cannot collect anything. An unlicensed electrician cannot recover. An unlicensed plumber cannot recover. No license, no money, no discussion.

Now suppose you do have a license but the contractor you are working for has no license. Your mechanic's lien is worthless and your claim is only against the contractor for breach of contract. Lots of luck!

How does that come about? You are a licensed electrician and you are doing work for a home improvement contractor who needs a license on a $3,000,000 condominium. If the contractor has no license, he cannot collect from the owner. Since a mechanic's lien that you would file as a licensed electrical contractor depends upon a balance due from the owner to the contractor, and the contractor is unlicensed, the owner owes the contractor nothing. You are out. Fair? No. The law? Yes.

Home improvement contractors require a license from the Department of Consumer Affairs. The whole thing costs about $250 every two years. It is a revenue raising requirement by the Department of Consumer Affairs. Yet, the absence of a home improvement license can cost the unwary contractor tens of thousands of dollars. He does the work, does it well, completes the job, and bingo, no payment because he does not have a home improvement license. The home improvement license is required for all

one- and two- and three-family houses within the City of New York. Every county requires a separate license. A license from Nassau County is not valid in Suffolk County. You have to be licensed in each county in order to recover, except in the City of New York where one license covers all five boroughs.

The trap here is that some major commercial contractors do people a "favor' and renovate their friend's home, only to find out that the "friend" is not a such a friend, and they get stuck for big bucks. Watch out for the licensing requirements.

Moreover, for commercial contractors, watch out for the contractors who hire you. If they have any licensing requirements of any kind, make sure that those licenses are in place. If they are not, run, do not walk, from the job.

Mortgage Priorities

The general rule is that a mortgage takes priority over subsequently filed mechanic's liens. If a mortgage is filed on January 15, 2011 and a mechanic's lien is filed on February 1, 2011, the general rule is that if the mortgage is foreclosed, the mechanic's lien will be wiped out because it was filed after the mortgage was filed. The general rule has exceptions.

A mortgage is a very highly technical document and a foreclosure of a mortgage is even more technical. Any deviation from the technicality may give the lien priority. This is particularly true of building loan mortgages that must be strictly adhered to by the bank or the lending institution in accordance with the filed documents. If these technicalities are not strictly complied with by the bank, and sometimes they are not, your lien may get priority.

All of the instances where such conditions occur cannot be laid out here, because they depend upon the particular facts of the particular instance at the particular time. Banks have lost their priority because of an omission or an oversight, or because they failed to comply with the law.

Bankruptcy

In most instances where a bankruptcy is filed, whether it be voluntary or involuntary, the poor lienor runs to the hills in a state of panic. In most instances, the bankruptcy does not affect the lien rights. Sometimes, it could even be beneficial. Handled properly, a lienor can collect under the bankruptcy in various ways.

In the first place, he has a lien against the property. This is the same a mortgage.

Secondly, the money that is generated from the project can be held back from the general assets of the bankrupt and kept from going into the estate. In other words, if a general contractor was doing ten jobs and went into bankruptcy, the money coming out of the building on which you have a lien can be held from becoming part of his overall assets that go into the bankruptcy and can be earmarked exclusively for the labor and material men on that particular job.

Thus, the telephone company, landlord, etc., could come behind the mechanic's lienor out of all funds coming out of a particular project.

Additionally, a special proceeding can be instituted in the Bankruptcy Court to isolate whatever monies come out of the particular project to make sure that that money is not applied to the general creditors of the bankrupt.

Accordingly, if there is a petition in bankruptcy filed, voluntary or involuntary, it is recommended that a lien be filed in any event, and that the outcome of the bankruptcy be watched carefully. Proof of claims can be filed and all rights in the bankruptcy can be preserved and they can run parallel to the lien. Where applicable, applications can be made to lift the automatic stay that comes into existence upon the filing of a petition.

Trust Funds

Construction money is in the nature of trust funds. The funds are earmarked for labor and material men and must be used to pay for the work performed and materials furnished on the particular project.

The statute specifically provides that co-mingling of trust funds constitutes a violation of the trust statute. Technically, the recipient of trust funds is supposed to isolate and segregate the money that he receives. This means that if a contractor has five jobs going, technically, he is supposed to keep the funds received from each of the five jobs separate and distinct in five different bank accounts. As a practical matter, however, this is rarely done and failure to do so is not a violation of the statute, but the funds must all go into a construction trust account and not into an operating account.

The trust provisions are violated when he does not pay the subcontractors or the labor and material men and he uses the money that comes out of a job either for another job or for his personal expenses. Money that is paid out of a particular job is earmarked for that particular job and he cannot pay his telephone bills, rent, office salaries, even his own salaries, out of these funds.

Normally, a corporation insulates the officers, stockholders and directors of a corporation from personal liability for corporate debts. This is the purpose of the corporation. Violations of the trust provisions of the statute permit the piercing of the corporate veil and allow you to go after the officers and directors personally if they were responsible for the disbursement of the funds. Everyone responsible for signing the checks and disbursing the funds becomes personally liable in addition to the corporation.

In very rare instances, the District Attorney or the Attorney General can prosecute these violations criminally. More often, however, the claims are prosecuted against the individuals civilly and personal judgments are entered against the individuals.

Arbitration

Any contractor or subcontractor who signs a standard AIA contract or any other contract consenting to arbitration should run to his nearest psychiatrist and have his head examined. As long as an arbitrator is honest, has not been bribed, has not concealed that he is your adversary's brother, etc., but does not know which end of a pencil to hold and which to stick into his ear, his decision is final and binding. Errors of law and fact do not justify the reversal of an arbitrator's decision.

Some decisions are unbelievably bizarre. They do not come cheap. In fact, they can be very expensive.

The American Arbitration Association becomes a percentage partner with the litigant. The fees you pay to the AAA are based upon the amount of your claim. For a claim up to $10,000 the fee is $975; to $75,000 it is $1,275; to $150,000 it is $2,600; to $300,000 it is $4,050; to $500,000 it is $6,100; to $1,000,000 it is $8,700; to $5,000,000 it is $11,450, etc. and that is just the initial filing. You also have a "proceeding" fee and "final" fees plus fees for the arbitrators that can run as much as $3,000 a day per arbitrator, plus "study time". And this is just for filing. In the Supreme Court the filing fee is $210 and the Judge is free. You decide if AAA is "cheap".

A complicated Lien Law claim can last ten, fifteen or more sessions. You figure out how much that would cost.

Moreover, a mechanic's lien cannot be foreclosed in arbitration. All an arbitrator can do is decide how much is due. He cannot order a foreclosure, cannot order the property to be sold at public auction, etc. To do that, you must have a court issue a judgment and a decree.

The quality of the proof that goes into evidence in an arbitration is absolutely incredible. What would be thrown out in Small Claims Court is accepted by arbitrators "for whatever it is worth". In the meantime, it goes into the record. Hearsay, double talk, garbage and nonsense all go into the record and are accepted "for what it is worth" and you never know what is meant by "what it is worth" because no one tells you.

Additionally, speed does not operate in the American Arbitration Association. You could be waltzed around for weeks, months and even years.

Difficulties in Litigation

Do not expect to institute an action in foreclosure and have everyone roll over and die. If you file a lien for $50,000 you can expect a defense that the lien is wilfully exaggerated, expect a counterclaim for maybe $250,000 and a defense that the general contractor was paid in full.

If your records are in order, have no fear. It might take a while, it might be difficult, but sooner or later, you will come before the Court and sooner or later, you will have your day in Court, and sooner or later, you will get your judgment. Just stick to it and build one step at a time until you accomplish what you started to do.

Shrewd and sharp defendants are aware of the fears and trepidations. Do not let them overwhelm you. If you have your records and make sure you are doing everything right, one step at a time, you will get there and you should succeed.

The Seven-Day Notice

This is a legitimate clause because the owner is entitled to have his job delivered within a reasonable period of time, particularly if time is not of the essence.

The contract, however, is a two-way street. It entitles the owner to have his job delivered, but it also requires the owner to make payments as and when they are due. An owner cannot sit on his throne and issue out orders and threaten the general contractor with a seven-day notice when he is substantially in default in making his payments. He cannot hold back monthly payments and expect the general contractor to finance his job.

A default in payment of the contract price, therefore, constitutes a default that could justify the general contractor leaving the job. This default, however, must be real, and not a figment of the general contractor's imagination. The general contractor cannot abuse the owner any more than the owner can abuse the general contractor The general contractor cannot put in charges for extras that are really part of the original contract, nor can he create issues where none exist. Where there is a legitimate extra and a legitimate bill that the owner refuses to pay, then the seven-day notice can be challenged as a self-serving declaration to avoid payment. The proper foundation has to be laid for that type of position, and it calls for a complete review of the contract.

Claims by the General Contractor

Subcontractors and material men are the ones who are the low men on the pole and are usually abused by both the general contractor and the owner. Both the owner and the general contractor are also subject to abuses by each other, but they are the ones who picked each other and they are the ones who entered into their agreements with each other.

An owner can be abused when the general contractor tries to create issues and extras when none exist. If he tries to charge for something that is part of the base contract and not legitimate extras or field orders, etc., he is, in effect, abusing the owner.

By the same token, the owner can abuse the general contractor by insisting that the general contractor do extra work and claim that extras are part of the original contract. The owner can also withhold payment claiming that the job is not progressing as required, is not properly coordinated or manned, is behind schedule and that time is of the essence, etc.

Both the owner and the general contractor can make "delay claims" against each other, but that is a fiasco and an issue that is beyond the scope of this little pamphlet. It calls for very substantial legal issues and legal arguments which can be subject to a book in itself. More often than not, these delay claims are a joke.

Municipal Contracts

Municipal contracts can be very tricky. In one instance, an electrical contractor lost $900,000 because he performed extra work and submitted all of the invoices for that extra work at the end of the job when he should have submitted them within five days after he did each extra. His claim for $900,000 was thrown out.

Municipal contracts have to be complied with strictly, to the letter, exactly as it is written. If you do not follow those contracts and do not comply with the specific provisions, you may be out.

Under normal circumstances, at least within the City of New York, for example, you must file a Notice of Claim within a certain period of time as a prelude to instituting the lawsuit.
Each contract may have its own provisions. In one contract, you may have to submit a Notice of Claim within fifteen days. In another, it may be thirty days. In another, it might be ninety days. You must follow that contract to the letter. The same thing applies to submission of bills and requisitions. You have to follow exactly what the contract says or you may find yourself without payment. Know your contract.

Pay When Paid Clauses

The standard practice was that the owner inserted a clause into his contract saying that he does not have to pay the contractor until he, the owner, gets paid from the bank. The contractor, in turn, provided that the subcontractor does not get paid until the general contractor got paid from the owner, and if that is never, then it is never.

That was modified by Court decisions. If a subcontractor does his work and it is inspected and is satisfactory, then there is no reason for the general contractor to hold back the

subcontractor's payment. To get around those rulings, the general contractor put in a clause calling it a "condition precedent" which meant that it was part of the contract as a condition to payment, that the subcontractor does not get paid until the general contractor receives payment, just as a subcontractor cannot get paid until he completes the work or does whatever he is supposed to do. It was a condition of the contract.

That has now been found to be against public policy and the "condition precedent" clauses are no longer enforceable. There are efforts, however, to by-pass those provisions. Some of the tricks used are that the installment payments are a "convenience" to the subcontractor, or that installment payments are conditioned, etc. All of these have to be tested in a Court until they play themselves out. The "condition precedent" clause, however, is outlawed at the present time.

Bonding companies now are trying to take advantage of it claiming that they do not have to pay various claims under a payment bond where the bond contains a pay when paid clause. They are claiming they are not the general contractor and they are not bound by the provisions of the contract. The tricks and excuses that are used to avoid payment are sometimes mind-boggling. The situations will also play themselves out ultimately.

Watch out for tricky clauses in the contract that might try to by-pass the pay-when-paid clauses either on requisitions or on retainage monies.

Retainage Money

As a corollary to the "pay when paid clause" the same applies to retainage monies.

The old trick was to have the subcontractor finance the project with his retainage money. The general contractor had a $100,000 contract with the owner which he subbed out to a subcontractor for $90,000. The owner held back 10% from the general contractor and the general contractor held back 10% from the subcontractor. The general contractor's net interest, therefore, was $1,000. If the general contractor never made a claim against the owner for the retainage money, it would cost him only $1,000 but it would cost the subcontractor $9,000. When the subcontractor made a claim against the general contractor, he would find all sorts of excuses not to release the $9,000 or "settle" for half and walk away with a cool $4,500 for doing nothing except ripping off the subcontractor. All of that is now past-tense.

Presently, retainage money is covered under the Prompt Payment Law, as well as recent amendments to the Lien Law.

Prompt Payment Law

We have on the books a so-called Prompt Payment Law which was greeted with dancing in the streets by contractors. The law said that if payment was not made within a certain period of time, the payor, (owner or general contractor) had to pay 1% interest per month. Everybody was ecstatic.

Not so fast. It may be a small step in the right direction, but it is far from Utopia.

The Prompt Payment Law applies to contracts over $150,000, does not include one, two and three family houses (and other exceptions) and particularly excludes public jobs. It requires a complicated billing cycle which gives the owner thirty (30) business days to remit payment after receipt of an invoice. If payment is contingent upon a receipt by the owner of a building loan installment, the lender has to approve the requisition and the owner has seven days after he receives payment to make payment to the contractor. How this impacts on a pay when paid provision remains to be seen.

With respect to a general contractor, the Prompt Payment Act requires that payment be made within seven (7) days after the general contractor receives funds from the owner.

The kicker here, however, is that nothing has really changed. The owner can still claim unsatisfactory work, disputed work, failure to comply with the provisions of the contract, failure to make payments to subcontractors or material men, etc. The only difference is that the owner has time limitations in which to assert the defenses and you can guess whether or not those defenses would be asserted.

Factoring Receivables

One way for a contractor to obtain money is factoring his receivables. Factoring involves a transaction where an invoice or a requisition is reviewed and a factor pays a percentage to the contractor of the receivable. The predetermined percentages may vary dramatically, but often are between 70% and 90% of the receivable.

Eventually, when the receivable is paid by the owner directly to the factor, the factor pays the remainder of the value of the receivable to the contractor's suppliers or subcontractors minus the factor's fees and administrative expenses.

There is a serious issue as to whether the factoring of the funds and the assignment of the receivable to a factor is considered a trust fund diversion. In order for the factor to be properly protected, it should file a Notice of Lending under the Lien Law to prevent them or the contractors from a claim of trust fund diversion.

If the project is under bid or there are cost overruns, the factor would not be able to pay the various subcontractors or suppliers. Thus, there would be a serious question as to whether the factor and thecontractor diverted trust funds by permitting the factor to accept the funds from the owner and pay itself all the fees due, without first paying the subcontractors or suppliers.

These issues, while they are technical and complicated, are relevant. It is imperative that you understand the ramifications that may exist in the event you factor your receivables.

Releases and Satisfactions

Once a Mechanic's Lien has been paid in full or at least to the satisfaction of the lienor, the lienor and/or the contractor, as the case may be, are entitled to a Satisfaction of the Lien. That means that there is a Satisfaction executed by the lienor which must be filed in the same place where the lien was originally filed, usually in the County Clerk's office, or possibly in the Register's Office in New York City.

The Satisfaction of the Lien and a Release are separate and distinct documents. The Satisfaction applies to the lien. The Release is much broader and should be executed with extreme caution.

If, for example, you have four jobs going with this one contractor and you lien one of the jobs and that lien is paid, the contractor is entitled to the satisfaction of the lien. A release, being much broader, might very well incorporate and include the other three jobs which you do not want to do. Unless, therefore, if you specify in the Release exactly what you are releasing you might be releasing obligations that you do not intend to release and that Release might be thrown up in your face.

The execution of a Release is so serious and requires so much consideration and thought, that it is strongly urged and suggested to be avoided whenever possible. If a Release is demanded and payment will not be made unless the Release is executed, the Release should be carefully worded and confined to the issues involved and not broadly executed so as to incorporate items not included in the transaction.

Liquidated Damages Clause

As a general rule, liquidated damages come into play when damages cannot be readily ascertained. For example, if a claim is made for lost profits, especially in a new business, it is virtually impossible to make a determination as to what those lost profits are or could be. As a result, an arbitrary number is assigned as "liquidated damages". If there is a breach in the contract, liquidated damages come into play.

Sometimes, liquidated damages can be recognized as being a penalty that is unenforceable. The general idea is to compensate the party injured, not to give him a windfall or to break the back of the other side.

Sometimes, liquidated damages might be insufficient. Where that is the case, a court will adjust the damages clause to do what is fair and reasonable. It will come to the aid of someone who has an insufficient liquidated damages clause.

The courts have rendered decisions on both sides of the issue, i.e., they have stricken liquidated damages clauses as penalties and they have adjusted liquidated damages clauses where they are insufficient.

It takes sophistication and understanding to know what type of yardstick to use when incorporating a liquidated damages clause into a contract. You do not want the clause stricken as a penalty or to take your chances in hoping that the court will come to your aid where it is insufficient.

Caution should be exercised when executing a contract with liquidated damages.

Business Alert

If you want to avoid getting hurt in the construction industry, our suggestions are as follows:

1. Know with whom you are doing business.

2. Check credit and references. Do not be ashamed or squeamish about asking for information.

3. Make sure you have the identity of a bond if a bond exists. Get a copy of a the bond at the time you sign your contract. If you cannot do that, get the name and address of the bonding company at the earliest possible date.

4. If you are a sub to a sub, get the name and address of the general contractor and find out if there is a bond on the job.

5. Get the real address, not a post office box, of the party with whom you are dealing.

6. Search the web for suits and judgments. Know your customer.

7. Find out who the principals and guarantors of your customer are.

8. Revamp your contract to protect yourself against fraud and deceit by getting personal representations from the principals.

9. Strike arbitration clauses, especially from the AAA.

10. Strike time of the essence clauses.

Telltale Signs of Troubled Waters

Any reader of this pamphlet could contribute a list of telltale signs where problems are in the horizon. Far be it for us to make up the excuses that the vivid imagination of people who do not want to pay a bill can concoct.

It is important, however, to file a mechanic's lien as soon as some of the signs crop up, because to do otherwise is to invite disaster.

Some of the telltale signs, however, that we have come across are as follows:

1. The check is in the mail.
2. What is your address.
3. No one is here to sign the check.

4. The check requires two signatures and one signatory is out of town.
5. We have to check it out.
6. We lost your bill.
7. The architect did not approve the work.
8. We are waiting for payment.
9. We were overcharged.
10. Your figures are wrong.
11. The building collapsed.
12. The check is in the computer.
13. The general contractor owes us money.
14. No one is here who can answer you.
15. The bookkeeper quit.
16. The office was burglarized.
17. Your check fell behind the file cabinet.
18. The landlord stole our records.
19. A burglar poured tar on our checkbook.
20. You didn't get the check? It went out last week.

Probably the funniest excuse of all is "Who are you?"

When you get some of those answers, or non-answers, or some other excuses that are too numerous to list here, look into liening the job. You are only kidding yourself and chasing rainbows if you do otherwise.

Conclusion

Do not let anyone pay you a half-day's pay for a full day's work. A mechanic's lien will help you collect.

Never let your lien time run out!

Summary of Time Frames

Private Improvement:

One family (also two family suggested) ..... 4 months

Commercial and more than one family ..... 8 months

Duration of Lien ..... 1 year

Renewal:

One family dwelling ..... Court Order
Two more renewals

More than one family and commercial - first year renewal ..... Notice of Renewal

After one year on more than one family
dwelling and commercial ..... Court Order

Public Improvement

Lien ..... 30 days after
completion and acceptance of job

Duration ..... 1 year

Payment Bond Notice:

Notice Directed to any two of Owner,
Bonding Company or Contractor bond
must be reviewed ..... Usually 90 days

Direct Contract with Principal -
bond must be reviewed ..... Usually no notice

Time for Commencement of action -
bond must be reviewed ..... Usually 1 year

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