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Standards for Review of Residential Construction Lien Matters Are Set

Court resolves several issues that were a source of litigation and confusion for the bar

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When New Jersey revamped the Construction Lien Law (“CLL”) in the 1990s, it decided to require additional filings for residential liens. The rationale behind the new rules was a desire to ensure a stable marketplace for families to acquire new homes without “delay or uncertainty.” N.J.S.A. 2A:44A-21. The new CLL acknowledged that there also existed a “need to provide contractors, subcontractors and suppliers with statutory benefits to enhance the collection of money for goods, services and materials provided for the construction of residential housing in the State of New Jersey.” In short, the legislature sought to not only protect consumers in the purchase of homes, but also to protect the contract rights of contractors, suppliers and subcontractors to obtain payment for goods and services provided. The resulting competing interests led to confusion among homeowners, contractors and their lawyers.

Residential Construction

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Liens are governed by the CLL, N.J.S.A. 2A:44A-1 et seq. Within the CLL, several sections relate specifically to the filing of a lien on residential property. These sections require that prior to filing a Construction Lien Claim (“CLC”), the lienor file a “Notice of Unpaid Balance” (NUB) and a demand for arbitration. The sufficiency of the NUB must then be determined by an arbitrator, who must render an award either allowing or denying the filing of a CLC. The statute requires that the NUB demand for arbitration conform to certain form requirements as well as timing requirements, and the courts have generally interpreted the statute strictly.

The recently published Appellate Division case of, *Schadrack v. K.P. Burke Builder, LLC*, 407 N.J. Super. 153; 970 A.2d 368 (App. Div. 2009), addressed how the courts and arbitrators should review imperfect NUBs and CLCs. *Schadrack* specifically ruled on (1) the standard of judicial review of residential lien arbitrations, (2) whether certain errors in the content of a lien render that lien unenforceable, (3) the effect of the arbitrator taking longer than the statute allows to render a decision, and (4)

when the untimely filing of a NUB, demand for arbitration or CLC is sufficiently prejudicial as to require the discharge of a NUB or CLC.

In *Schadrack*, two contractors who performed work on plaintiff’s residence experienced problems obtaining payment and eventually filed residential construction liens. The first contractor, K.P. Burke Builder, LLC filed a NUB with the county clerk pursuant to the CLL. However, Burke erred in failing to include a demand for arbitration in its filing and service of the NUB. As a condition precedent to the filing of any residential lien claim, a claimant must first file and serve a NUB and then claimant must also, simultaneously with the service of a NUB, serve a demand for arbitration and fulfill all the requirements and procedures of the American Arbitration Association (AAA) to institute an expedited proceeding before a single arbitrator designated by the AAA. Burke later filed what was entitled an “amended” NUB and simultaneously served the AAA and plaintiffs with a demand for arbitration.

The second contractor, L.E.D. Electrical & Mechanical Contractors, LLC, filed its own NUB it contem-

poraneously served and filed a demand for arbitration on the AAA and plaintiffs. However, plaintiffs opposed LED's lien claim because the demand for arbitration failed to include documentation supporting LED's claim. After it received plaintiffs' opposition, LED filed a supplemental submission containing pertinent supporting documents. In both matters, the arbitrator found in favor of the contractors and the trial court upheld the arbitration award.

In upholding the arbitration award, the trial court used the standard of review set forth in the New Jersey Arbitration Act, N.J.S.A. 2A:24-1 to -11. Under the Arbitration Act, the reviewing court may only vacate an award due to fraud, impartiality or misconduct, N.J.S.A. 2A:24-8(a)-(d), or modify an award based on mistake or miscalculation, N.J.S.A. 2A:24-9.

On appeal, the plaintiffs argued that the CLL requires strict compliance, and that the trial court applied an incorrect standard of review in evaluating the arbitration award. In determining *de novo* to be the correct standard of review, the Appellate Division looked to the language of the CLL, which directs that residential CLL arbitration awards lack finality and that either party can appeal to the Superior Court of New Jersey for a "vacation, modification or correction" of the award. Because the CLL contained its own *de novo* standard of review, the Appellate Division held that the Arbitration Act did not apply to reviews of CLL arbitration awards.

Using the *de novo* standard to review the issues raised by plaintiffs, the court looked to the statute, which requires the parties to "fulfill all the requirements and procedures of the American Arbitration Association . . ." N.J.S.A. 2A:44A-21(b) (3). AAA Rule

6 allows amendments to be made to a demand for arbitration with the assent of the arbitrator or the parties, and the arbitrator implicitly gave LED such permission to amend its filing by accepting and considering LED's supplemental materials.

More importantly, perhaps, the Appellate Division discussed the plaintiffs' accusation that allowing the supplemental documents resulted in prejudice. In rejecting that argument, the court recognized that the arbitrator's decision comprises "the establishment of a 'prejudgment lien' that must be confirmed in litigation subsequently brought pursuant to N.J.S.A. 2A:44A-14." Even with a lien approved by the arbitrator, the contractor still must prove entitlement to recovery on the merits.

After resolving the LED issue, the court looked to Burke's untimely service issues and easily held that Burke's delay in serving the arbitration demand was excusable. The Appellate Division found N.J.S.A. 2A:44A-7 applicable, which states that "the service of a lien claim outside the prescribed time period shall not preclude enforceability [of the lien claim] unless the party not timely served proves by a preponderance of the evidence that the later service has materially prejudiced its position." Material prejudice "may be demonstrated, in a *prima facie* manner, by an owner's disbursement of funds or a conveyance of an interest in the property 'without actual knowledge of the filing of the lien claim.'" (citing N.J.S.A. 2A:44-7). The pendency of a lien claim, by itself, does not constitute the material prejudice required by Section 7 because this would, necessarily, be the situation in every case.

The last issue addressed by the court was plaintiffs' contention that the Burke AAA arbitration was invalid be-

cause it was not completed within the 30-day time frame contemplated by N.J.S.A. 2A:44A-21(b)(6). The hearings were held more than 30 days after Burke served its original NUB, but within 30 days from when Burke served the amended NUB. In allowing extra time to complete arbitrations, the standard set forth by the court in allowing extra time was one of "unfairness to the parties" and whether the delay was "inimical to the text or spirit of the statute." Noting that parties do not have control of the arbitrator's calendar, the court said that the CLL's 30-day arbitration requirement should not be interpreted "so rigidly as to eliminate the ability of the AAA, within reason, to make appropriate adjustments in its scheduling and completion of proceedings."

The *Schadrack* legal rulings resolved several issues that were a source of litigation and confusion for the bar. The standards of review the court set forth will greatly assist attorneys, arbitrators and trial courts in grappling with the complicated problems the residential CLL has created. The *Schadrack* case may, in turn, become a seminal case in the area of the residential CLL. Despite the number of legal quandaries the *Schadrack* court addressed in its ruling, a number of other uncertainties in the residential CLL still wait to be resolved.

For instance, an unanswered question is whether contractors performing purely commercial work on mixed-use developments (i.e. buildings that include both residential and commercial space), must file a NUB and demand for arbitration prior to filing a CLC. These questions may be resolved in a new revision to the CLL, which is currently being drafted by the New Jersey Law Revision Commission. ■