2002 Report to the Legislature:

Proposed Mechanics' Lien Reforms

Submitted by: The New York State Law Revision Commission

I. Introduction

This report is the result of the Commission's study of certain inefficiencies in the lien law relating to mechanics' liens.[1] Specifically, the Commission examined the current statutory scheme by which an owner or prime contractor can post a bond to discharge a mechanics' lien on a public or private improvement. After extensive study, the Commission concluded that the court orders required to be obtained by owners or prime contractors cause significant and unnecessary expense and delay, and that the interests and rights of the lienholder would remain protected under a more streamlined process.

II. Mechanics' Liens

Briefly, the Lien Law prescribes two types of mechanics' liens: those under contracts for privately owned improvements (§ 3)[2] and those under contracts for public improvements (§ 5). Although the rights and procedures associated with each differ, both were enacted to protect contractors, subcontractors and suppliers who have a financial interest in an improvement to real property.[3] A private improvement lien attaches to the real property on which the improvement is made. A public improvement lien attaches to the monies the state or public entity has appropriated for the improvement. However, under both, the lien holder is limited to the amount the owner owes the prime contractor at the time the lien is filed.

Under the statutory schemes prescribed for both private and public improvement mechanics liens, the owner or prime contractor may avoid the effect of the lien by "bonding off the lien." This requires securing at least two court orders. First, the owner or contractor must obtain a court order setting the amount of a bond to discharge the lien.[4] Once the bond has been secured, the owner or prime contractor must then apply to the court for an order approving the bond and discharging the lien; the application must also be served on the lienholder with two days notice.[5] Upon approval, the order is then filed with the entity in which the notice of lien

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[1] The issues discussed in this report were brought to the attention of the Commission by the Construction Committee of the New York County Lawyers' Association.

[2] Unless otherwise noted, all section citations are to the Lien Law.

[3] See, Schaghticoke Powder Co. v Greenwich & J RR Co., 183 NY 310 (1905).

[4] Lien Law § 19(4) [private liens]; § 21(5) [public improvement liens].

[5] id.

was filed and the lien is discharged.[6] The Commission has determined that both of these court applications could be streamlined by avoiding the need for direct court involvement.

III. Issues and Recommendations

A. **Recommendation: Establish a Statutory Formula Fixing the Amount of the Bond**

The relevant statutes relating to both private and public improvements first require that the owner or prime contractor secure a court order fixing the amount of the bond. These statutes prescribe that the bond be "not less than the amount claimed in the notice of lien conditioned for the payment of any judgment which may be rendered against the property for the enforcement of the lien" (Lien Law § 19[4], § 21[5]). The amount may also include costs and interest.

New York courts generally have an internal "rule of thumb" for fixing the amount of a bond: the face amount of the claim plus one year's interest plus a small increment for statutory costs. Thus, the expense and time required to obtain an order that requires no particular judicial expertise is unnecessary. Depending on the individual court's caseload, there can be substantial delay in obtaining such an order. In the meantime the property remains encumbered, which, in turn, will often prompt the owner to withhold payments to the prime contractor, thus cutting off needed cash flow.

States that have responded to this issue have done so by eliminating the requirement that a court set the amount of the bond in favor of statutorily prescribing the amount. Of the 16 major states studied on behalf of the Commission, 13 have adopted this practice.[7] Seven of these set the amount at double the claim amount.[8] On the other end of the spectrum, three states (Florida, Massachusetts and Tennessee) set the amount of the bond to be the amount of the claim plus nominal interest and costs. The remaining states set the amount at 150% (California), 125% (North Carolina) and 110% (New Jersey).

The obvious advantage of adopting a statutorily prescribed lien amount is that it eliminates the delay and expense associated with obtaining a court order. It also reduces the burden on the courts.

The Commission further recommends that the statute fix the amount of the bond at 110% of the lien amount. This percentage reflects the courts' current practice of setting the amount

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[6] id.

[7] Arkansas, California, Florida, Kentucky, Massachusetts, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Texas and Virginia.

[8] Texas and Ohio permit the amount to be 150% of the claim amount where the claim is in excess of a specified amount.

equal to the lien plus one year's interest plus nominal costs. Although the Commission considered setting the percentage at an amount higher than 110%, it was ultimately determined that a higher percentage would result in bonding costs in excess of those currently incurred.

B. **Recommendation: Eliminate Court Approval of Bond and Substitute the CPLR article 25 Undertaking Procedure**

Presently, upon obtaining a bond to discharge a lien on both public and private improvements, the owner or prime contractor must also, on notice to the lien holder, obtain court approval of the bond and an order discharging the lien.[9] Lien Law § 19(4) [private] and § 21(5) [public] prescribe the necessary showings and notice periods in relation to the extent to which the surety is authorized and certified by the State.

There is some criticism of the necessity of seeking yet another court order to effectuate the discharge, particularly in cases where the bond obtained is from an authorized and certified fidelity or surety company. Although the primary purpose of seeking approval is to permit the lienholder to object to the sufficiency of the bond, experienced practitioners universally agree that objections are rarely filed. Under such circumstances, the time and expense associated with securing a court order might be considered unnecessary. Moreover, the courts are also needlessly burdened with a matter that is more administrative than judicial in nature.

The vast majority of the 16 states studied have recognized the inefficiency of requiring court approval of bonds to discharge liens. Of the 14 states studied that permit bonding off a lien, 10 permit discharge of a lien upon filing of a bond with the appropriate clerk.[10] Generally, these states require notice to the lien holder, but make the discharge effective upon the date of filing or recording.[11] Other states suspend the effective date of the discharge to the end of the notice period during which the lien holder may object to the sufficiency of the bond and/or sureties.[12]

The role of the clerk in this process varies. In some states, the clerk is charged with ensuring that the bond is sufficient in regard to both amount and approved sureties.[13] In other jurisdictions, the clerk is merely charged with filing or recording the bond; the burden is on the

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[9] See, Lien Law § 19(4); § 21(5).

[10] Arkansas, California, Florida, Kentucky, Massachusetts, Michigan, New Jersey, North Carolina, Tennessee and Texas.

[11] See, e.g., California, Florida, Kentucky, Massachusetts, New Jersey, North Carolina, Tennessee, and Texas.

[12] Arkansas and Michigan.

[13] Arkansas, Kentucky, Massachusetts, Michigan.

lien holder to file objections to a bond's sufficiency with the appropriate court.[14]

In evaluating a more streamlined alternative for New York, the Commission turned to CPLR article 25. Article 25 governs virtually every other bonding process, including the filing of bonds to stay the enforcement of a judgment or order pending appeal.[15] "Wherever in the CPLR an undertaking, often referred to as a bond, may be statutorily or voluntarily furnished by the party, the detailed rules governing it will be found in Article 25 of the CPLR" (Siegel, NY Prac § 206 [2d ed]).

The "mechanics" of article 25 are as follows. Once the amount of the bond is established (by statute, rule or order),[16] the party providing the bond files it with the appropriate clerk and serves a copy upon the adverse party; the undertaking is effective upon completion.[17] If a certificate of qualification is filed along with the bond, the bond stands.[18] If a certificate of qualification is not filed, a party has 10 days to object to the sufficiency of a surety by serving a written notice of exception on the party filing the bond.[19]

In the event the adverse party objects to the bond, the surety or the person on whose behalf the undertaking is given, must move to justify the undertaking upon notice to the adverse party within 10 days after service of the notice of exception. If, at the hearing, the surety offers sufficient justification, the court will indorse the undertaking.[20] If no motion to justify is made, the undertaking is without effect, except that the surety will remain liable on it until a new undertaking is given and allowed.[21] However, "[a]s the paucity of cases suggests, the notice of exception procedure is almost never invoked" (City of New York v Britestarr Homes, 150 Misc 2d 820 [Bronx Cty. 1991]).

Finally, CPLR 2508 permits any interested person to move for a new or additional

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[14] California, Florida, New Jersey, North Carolina, Tennessee, Texas.

[15] See, CPLR 5519.

[16] See, 1991 Legislative Studies and Reports, McKinney's Cons Laws of NY, Book 7B, §2501.

[17] See, CPLR 2505.

[18] A certificate of qualification is issued by the Superintendent of Insurance pursuant to Insurance Law § 1111.

[19] See, CPLR 2506.

[20] See, CPLR 2507(a).

[21] See, CPLR 2507(b).

undertaking or justification even after the exception period has expired. However, the party seeking the modification has the burden of demonstrating the merits of the change.[22] This is a significant benefit not currently found in the law related to private liens.[23] Importantly, the fact that a party may move for justification or a new or additional undertaking *at any time*, ensures that the judgment creditor will remain protected should the circumstances of the parties or surety change (see, id.) Thus, for example, by making CPLR 2508 available, the lienholder is able to seek an increase in the bond to cover additional accumulated interest and costs in prolonged actions.

Research tracing the history of these sections of the Lien Law fails to reveal the purpose of requiring court approval of the bond given to discharge a lien on either a private or public improvement. The language requiring court approval in Lien Law § 19 and §21 dates back to at least the late 1800's (see, Copley v Hay, 12 NYS 277 [1891]), and may have existed before then.[24] Because the provisions contained in CPLR article 25 were enacted separately, but also long ago, it is assumed that the Lien Law subsections at issue predate CPLR article 25 and, therefore, employ different requirements. Unfortunately, due to the age of the provisions and the lack of case law discussing the issue, the original intent of the different requirements cannot be determined with certainty.

IV. The Commission's Recommendation

Accordingly, the Commission determined that the provisions of CPLR article 25 may be appropriately substituted for the court application approving bonds issued by authorized fidelity and surety companies required in Lien Law § 19(4) § 21(5). This proposal would create the following procedures for posting a bond or undertaking to discharge a lien on a public or private improvement.

1. **Amount of Bond**
The party seeking to discharge the lien would obtain a bond in the amount of 110% of the lien amount.

2. **Filing of Bond - Procedural and Justification Requirements**

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[22] See, New York v Britestarr Homes, 150 Misc 2d 820 (1991).

[23] Lien Law § 21(5) states that "[e]xcept as otherwise provided herein the provisions of article twenty-five of the [CPLR] regulating undertakings . . . [is] applicable to an undertaking given for the discharge of a lien on account of public improvements."

[24] Lien Law § 19(4) was derived from the Lien Law of 1897, c. 418, as amended by L. 1908, c. 254. The section was originally revised from L. 1885, c.342, L. 1875, c.392, and L. 1880, c.440. Lien Law § 21 was derived from L. 1911, c. 873, § 5 and originally derived from L. 1897, c. 418, § 20.

(a) If the bond is obtained from a surety or fidelity company authorized by the State to transact business, and a current certificate of qualification has been issued by the Superintendent of Insurance pursuant to Insurance Law § 1111, the bond will be filed where the notice of lien is filed, and a copy of the bond must be served on the lienholder. The party posting the bond will not be required to justify the bond. The bond will be effective upon filing.

> **COMMENT:** This procedure is virtually identical to that required under CPLR 2505 and 2506 when a bond is filed from an authorized surety in possession of a certificate of qualification. Significantly, even under the current lien law, a surety providing a bond that is so qualified is not required to justify the bond to the court. Thus, as long as notice is given, the court's role is merely to provide an order discharging the lien. Given this incidental role, the Commission concludes that the court order is wholly unnecessary and that CPLR 2505 and 2506 are adequate.

(b) If the bond is obtained from a surety or fidelity company authorized by the State to transact business, *but no current certificate of qualification has been issued to it*, the bond will be filed where the notice of lien is filed and a copy of the bond must be served on the lienholder. The bond is effective upon filing. The lienholder will then have 10 days to serve a notice of exception on the party filing the bond.[25] If the lienholder fails to serve a notice of exception, the bond is allowed. If the lienholder files a notice of exception, the party filing the bond then has 10 days to file a motion to justify on notice to the lienholder. If the party seeking to discharge the bond fails to move to justify or is unable to justify at a hearing, the bond will be without effect, but the surety will remain liable on it until a new undertaking is given.[26] If the party succeeds in justifying the bond, the court will indorse the undertaking.[27]

> **COMMENT:** Under the current provisions of the Lien Law, the party offering the bond must obtain a court order discharging the lien when the bond is issued by an authorized surety, but no certificate of qualification has been issued to it. Presumably, the issuance of an order discharging the lien is based on the sufficiency of the bond. Because the application for such an order must be made on notice to the lienholder, the lienholder has the right to object, though this rarely occurs. Under the proposed scenario, the court would become involved only if the lienholder objects to the sufficiency of the bond, thus protecting the interests

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[25] See, CPLR 2506(a).

[26] See, CPLR 2507(b).

[27] See, CPLR 2506(b); CPLR 2507(a)

of the lienholder while eliminating unnecessary court involvement.

(c) If the party seeking to discharge the lien *fails to offer a bond from a surety of fidelity company authorized by the State to transact business*, the party must follow the procedures currently set forth in Lien Law § 19(4) and § 21(5), i.e., the party must execute a bond with two or more sufficient sureties to the entity where the notice of lien is filed and serve the lienholder with five days notice that the sureties will justify before the court. If the justification is sufficient, the court will issue an order discharging the lien.[28]

> **COMMENT:** In situations where the party seeking to discharge the lien obtains a bond from a private source not formally authorized by the State, the Commission believes that the current Lien Law's absolute requirement of a court order discharging the lien is necessary to fully protect the interests of the lienholder. In this case, the expertise of the court may be required in determining the sufficiency of the bond. Thus, it is prudent to retain this provision.

3. **Applicability of CPLR article 25**

Except as provided in section 2, *supra*, CPLR article 25 will govern, including CPLR 2508, which permits the lienholder to seek modification of the bond.

> **COMMENT:** Limited applicability of CPLR article 25 is already provided for under Lien Law § 21(5) [public improvements]. Because CPLR 2508 and other provisions in article 25 generally may benefit and protect the interests of the lienholder, the Commission recommends that article 25 be made applicable to Lien Law § 19(4) [private improvements] as well.

In further support if its recommendation that the Lien Law be amended by providing that CPLR article 25 will govern, except as otherwise provided in the Lien Law, it is noted that article 25 governs all other undertakings provided in civil actions and proceedings and, thus, is both a familiar and effective procedure.[29] Moreover, employing CPLR article 25 to govern private mechanics' liens would have virtually no fiscal impact. Bonds and undertakings are filed under the index number purchased at the outset of the action. Thus, no additional fee is required.[30]

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[28] See, Lien Law § 19(4) and § 21(5).

[29] See, 11 NY Jur 2d Bonds § 10 (1996).

[30] See, 1967, Op. Atty. Gen. (Inf.) 128; CPLR 8021

IV. Conclusion

The current statutory scheme for posting a bond to discharge a mechanics' lien is unnecessarily burdensome and inefficient. Amending the Lien Law to statutorily fix the amount of a bond and to substitute the undertaking procedures of article 25 of the CPLR when a bond is issued by a qualified surety will streamline the bonding process while offering the holder of a mechanics' lien protection equal to that provided under the current scheme. A proposed bill and incorporating the changes discussed herein is set forth in Appendix A.

Appendix A: Proposed Bill Amending the Lien Law
(Submitted by the New York State Law Revision Commission)

AN ACT to amend the lien law, in relation to streamlining the process by which a bond is posted to discharge a mechanics' lien on a public or private improvement.

THE PEOPLE OF THE STATE OF NEW YORK, REPRESENTED IN SENATE AND ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. Subsection (4) of section 19 of the lien law is REPEALED.

Section 2. New subsection (4) to be added as follows:

(4) Either before or after the beginning of an action by the owner or contractor executing a bond or undertaking in an amount equal to one hundred ten percent of such lien conditioned for the payment of any judgment which may be rendered against the property for the enforcement of the lien.

a. The execution of any such bond or undertaking by any fidelity or surety company authorized by the laws of this state to transact business, shall be sufficient; and where a certificate of qualification has been issued by the superintendent of insurance under the provisions of section one thousand one hundred eleven of the insurance law, and has not been revoked, no justification or notice thereof shall be necessary. Any such company may execute any such bond or undertaking as surety by the hand of its officers, or attorney, duly authorized thereto by resolution of its board of directors, a certified copy of which resolution, under seal of said company, shall be filed with each bond or undertaking. Any such bond or undertaking shall be filed with the clerk of the county in which the notice of lien is filed, and a copy shall be served upon the adverse party. The

undertaking is effective when so served and filed. If a certificate of qualification issued pursuant to subsections (b), (c) and (d) of section one thousand one hundred eleven of the insurance law is not filed with the undertaking, a party may except to the sufficiency of a surety by a written notice of exception served upon the adverse party within ten days after receipt of a copy of the undertaking. Exceptions deemed by the court to have been taken unnecessarily, or for vexation or delay, may, upon notice, be set aside, with costs. Where no exception to sureties is taken within ten days or where exceptions taken are set aside the undertaking is allowed.

b. Bonds or undertakings not executed pursuant to subdivision (a). The owner or contractor shall execute an undertaking with two or more sufficient sureties, who shall be free holders, to the clerk of the county where the premises are situated. The sureties must together justify in at least double the sum named in the undertaking. A copy of the undertaking, with notice that the sureties will justify before the court, or a judge or justice thereof, at the time and place therein mentioned, must be served upon the lienor or his attorney, not less than five days before such time. Upon the approval of the undertaking by the court, judge or justice an order shall be made by such court, judge or justice discharging such lien.

c. If the lienor cannot be found, or does not appear by attorney, service under this subsection may be made by leaving a copy of said undertaking and notice at the lienor's place of residence, or if a corporation at its principal place of business within the state as stated in the notice of lien, with a person of suitable age and discretion therein, or if the house of his abode or its place of business is not stated in said notice of lien and is not

known, then in such manner as the court may direct. The premises, if any, described in the notice of lien as the lienor's residence or place of business shall be deemed to be his said residence or its place of business for the purposes of said service at the time thereof, unless it is shown affirmatively that the person serving the papers or directing the service had knowledge to the contrary. Notwithstanding the other provisions of this subsection relating to service of notice, in any case where the mailing address of the lienor is outside the state such service may be made by registered or certified mail, return receipt requested, to such lienor at the mailing address contained in the notice of lien.

d. Except as otherwise provided herein, the provisions of article twenty-five of the civil practice law and rules regulating undertakings is applicable to a bond or undertaking given for the discharge of a lien on account of private improvements.

Section 3. Subsection (5) of section 21 of the lien law is REPEALED.

Section 4. New subsection (5) is added as follows:

(5) Either before or after the beginning of an action by a contractor or subcontractor executing a bond or undertaking in an amount equal to one hundred ten percent of such lien conditioned for the payment of any judgment which may be recovered in an action to enforce the lien.

a. The execution of any such bond or undertaking by any fidelity or surety company authorized by the laws of this state to transact business, shall be sufficient; and where a certificate of qualification has been issued by the superintendent of insurance under the

provisions of section one thousand one hundred eleven of the insurance law, and has not been revoked, no justification or notice thereof shall be necessary. Any such company may execute any such bond or undertaking as surety by the hand of its officers, or attorney, duly authorized thereto by resolution of its board of directors, a certified copy of which resolution, under seal of said company, shall be filed with each bond or undertaking. Any such bond or undertaking shall be filed with the State or the public corporation with which the notice of lien is filed and a copy shall be served upon the adverse party. The undertaking is effective when so served and filed. If a certificate of qualification issued pursuant to subsections (b), (c) and (d) of section one thousand one hundred eleven of the insurance law is not filed with the undertaking, a party may except to the sufficiency of a surety by a written notice of exception served upon the adverse party within ten days after receipt of a copy of the undertaking. Exceptions deemed by the court to have been taken unnecessarily, or for vexation or delay, may, upon notice, be set aside, with costs. Where no exception to sureties is taken within ten days or where exceptions taken are set aside the undertaking is allowed.

b. Bonds or undertakings not executed pursuant to subdivision (a). The owner or contractor shall execute an undertaking with two or more sufficient sureties, who shall be free holders, to the state or public corporation with which the notice of lien is filed. The sureties must together justify in at least double the sum named in the undertaking. A copy of the undertaking, with notice that the sureties will justify before the court, or a judge or justice thereof at the time and place therein mentioned, must be served upon the lienor or his attorney, not less than five days before such time. Upon the approval of the

undertaking by the court, judge or justice an order shall be made by such court, judge or justice discharging such lien.

c. If the lienor cannot be found, or does not appear by attorney, then service under this subsection may be made as prescribed in subdivision (c) of subsection four of section nineteen of this chapter for the service of an undertaking with notice of justification of sureties. Notwithstanding the other provisions of this subdivision relating to service of notice, in any case where the mailing address of the lienor is outside the state such service may be made by registered or certified mail, return receipt requested, to such lienor at the mailing address contained in the notice of lien.

d. Except as otherwise provided herein, the provisions of article twenty-five of the civil practice law and rules regulating undertakings is applicable to a bond or undertaking given for the discharge of a lien on account of public improvements.

Section 5. This bill shall take effect January 1, 2003.