

New Jersey Appeals Court Clarifies Allocation of Funds Under Construction Lien

by Michael Cifelli on January 7, 2013

New Jersey's Construction Lien Law allows a contractor or supplier who is owed payment for its work or materials to file a lien against the real property on which the improvements are constructed. The Appellate Division recently clarified how subsequent payments must be allocated under a lien.

Under existing precedent established in *Craft v. Stevenson Lumber Yard Inc.*, 179 N.J. 56 (2004), a materials supplier that seeks to file a construction lien is obligated to apply payments already made by the materials purchaser, such as the project/property owner through payments to its general contractor, if the supplier has reason to know that those payments came from the building project against which the supplier seeks to file the lien. Otherwise, the supplier cannot establish the existence of the true debt and no lien may attach under the construction lien law. In turn, *L&W Supply Corporation v. DeSilva* specifically considered the extent of the obligation of the materials supplier "to ascertain the source of payments and to apply them accordingly."

The Facts of the Case

Plaintiff L&W Supply Corporation sold building materials on credit to a now-bankrupt subcontractor, Detail Contractors, Inc. When Detail failed to pay the full balance due for the materials, L&W filed a construction lien against the project for which the materials were supplied.

L&W subsequently filed a complaint to collect against Patoch Construction Co., Inc., the general contractor for the project; Extended Medical Care Corp./Meridian Health/Meridian Nursing & Rehabilitation ("Meridian"), the owner of the property and of the construction project; and Travelers Casualty and Surety Company of America, the surety. On appeal, the defendants contended that the amount L&W was actually owed for materials supplied to the Meridian project was significantly lower than the amount claimed. They specifically argued that L&W had a duty to apply other payments made during the specified time period to the Meridian account. Thus, the Appellate Division was asked to determine the lengths to which a supplier must go to discharge its duty to allocate payments accurately.

The Court's Decision

The Appellate Division ultimately concluded that because *Craft* imposes an affirmative duty upon the supplier to allocate payments correctly, the supplier must inquire about the

source of payments it receives. The court further held that “a failure to do so may warrant a finding that the supplier should have known the source of the payment.”

As explained in the opinion, “The law should not generally require a supplier to challenge a materials purchaser without reason to suspect improper allocation of funds. However, if the supplier has reason to suspect that something is amiss in the material purchaser’s allocation of payments to different accounts, Craft requires that the supplier inquire further and verify the source of the payment funds.”

Finally, the panel also emphasized that the duty imposed by Craft does not affect the supplier’s right to collect all balances due from the person or entity that purchased the materials, or from any other party contractually obligated to pay for the materials. Rather, the supplier’s failure to take affirmative action to ascertain the source of funds affects only its right to encumber the real property of the owner.

If you have any questions about this case or would like to discuss your obligations under New Jersey’s construction lien law, please contact me, Michael Cifelli, or the Scarinci Hollenbeck attorney with whom you work.