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The Enforceability of Mechanics' Liens in Bankruptcy Is Dependent on State Law

In a recent decision, the Third Circuit Court of Appeals held that a mechanic's lien filed by an unpaid supplier against a construction project, after the contractor through whom the materials were furnished filed for bankruptcy protection, was voidable. However, the Court noted that this doesn't apply if applicable state law permitted the lien to relate back to a date prior to the filing of the petition. Under the laws of most states, perfected mechanics' liens do in fact relate back to the first day on which the lienor furnished labor, materials, or equipment to the construction project. This holding has particular significance to contractors and suppliers in the construction industry, who typically furnish materials or perform work on a project under an agreement where retainage is withheld and payment for the work performed is not due until 45 or 60 days later and too often after the contractor has filed for bankruptcy protection.

In re Linear Electric Co., No. 16-1477 (3rd Cir. March 30, 2017), involved a supplier who sold materials on credit to a construction contractor. The contractor incorporated the materials into a construction project for a third-party property owner but failed to pay the supplier in full. The contractor later filed a Chapter 11 case, and the supplier sought recovery by filing a construction lien on the third-party's property pursuant to New Jersey's Construction Lien Law (N.J.S.A. § 2A:44A-1).

The contractor then filed a motion in its Chapter 11 case requesting the discharge of the lien on the grounds that it violated the automatic stay provision under the Bankruptcy Code. See 11 U.S.C. § 362. Once a debtor files for bankruptcy, the automatic stay prohibits a creditor from creating, perfecting, or enforcing any lien against property of the estate.

The supplier argued that, because the lien encumbered property of the third-party owner, rather than that of the contractor, it did not violate the automatic stay. The bankruptcy court rejected this argument, holding the supplier in violation of the stay and voiding the lien. On appeal, the Third Circuit agreed with the bankruptcy court. The Third Circuit reasoned that, because the lien permitted recovery from the third-party owner for money owed to the contractor, it effectively acted as a lien on the contractor's accounts receivable. The accounts receivable were an asset of the estate and were therefore subject to protection by the automatic stay provision. Accordingly, the supplier's lien was voided.

The Third Circuit acknowledged the result would have been different if applicable state law provided for the mechanics' liens to relate back prior to the filing of the bankruptcy petition. The Court noted that in another case, *In re Yobe Electric, Inc.*, 728 F.2d 207 (3rd Cir. 1984), the filing of a mechanic's lien by a subcontractor did not violate the automatic stay provision because, under Pennsylvania law, the date of filing the mechanic's lien related back to "the date of visible commencement upon the

ground of the work of erecting or constructing the improvement.” New Jersey law contained no such provision; therefore, the mechanic’s lien was effective only as of the date of filing.

Consequently, under the Third Circuit’s analysis, a mechanic’s lien filed after the bankruptcy commences could remain valid if the state’s law contains a “relation back” provision. Below is a quick summary of the mechanic’s lien statutes in New York, Connecticut, Massachusetts, and Rhode Island:

- In New York, a mechanic’s lien relates back to the date of the underlying debt’s creation. See NY Lien L. § 13(5). Accordingly, bankruptcy courts applying New York law have held that the filing of a mechanic’s lien is not barred by the automatic stay. See *In re LoPriore*, 115 B.R. 462, 463 (Bankr. S.D.N.Y. 1990); *Matter of Fiorillo & Co.*, 19 B.R. 21 (Bankr. S.D.N.Y. 1982).
- Similarly, in Connecticut a mechanic’s lien relates back to the date on which the lienor first furnished labor, materials, or equipment to the construction project. Conn. Gen. Stat. § 49-33 (b) (The claim is a lien on the land, building, and appurtenances or lot or, in the event that the materials were furnished or services were rendered, in the site development or subdivision of any plot of land and then on the plot of land. The claim takes precedence over any other encumbrance originating after the commencement of the services or the furnishing of any such materials, subject to apportionment as provided in section 49-36).
- In Massachusetts, a mechanic’s lien becomes effective for all purposes upon the date the lien is perfected pursuant to statute. See MGL c. 254, §§ 1-33; *Tremont Tower Condominium LLC v. George B.H. Macomber Co.*, 436 Mass. 677 (2002). The lien does not relate back to the date work commenced or when services were rendered.
- In Rhode Island, a mechanic’s lien relates back and protects all work performed by the lienor within 200 days prior to the recording date. This time period constitutes the “Lien Period.”

Suppliers and contractors in the Northeast may wish to understand the various differences in state law governing mechanics’ liens. In states lacking a “relation back” provision, a bankruptcy petition will likely bar the subsequent filing of a mechanic’s lien. However, in states where the law provides for the relation back of mechanics’ liens, a post-bankruptcy petition lien will likely fall outside the scope of the automatic stay, at least for the applicable grace period for filing.

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