

UNIFORM CONSTRUCTION LIEN ACT*

Drafted by the

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ON UNIFORM STATE LAWS

and by it

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UNIFORM CONSTRUCTION LIEN ACT

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UNIFORM CONSTRUCTION LIEN ACT

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UNIFORM CONSTRUCTION LIEN ACT

PREFATORY NOTE

This Act is based almost entirely upon Article 5 (Construction Liens) of the Uniform Simplification of Land Transfers Act. That Act was promulgated by the National Conference of Commissioners on Uniform State Laws in 1976 and amended in 1977. In 1985, the Conference appointed a drafting committee to draft a free standing construction lien act based on the 1977 Act. The decision to prepare a free standing act rested on the assumption that many states might be interested in adopting a modern uniform mechanics' lien act but would not be interested in some other aspects of the Uniform Simplification of Land Transfers Act which deals with such things as prerequisites for recording in the land records, general priorities among purchasers of land, and so on. In fact, in 1981, Nebraska had extracted the Construction Lien Article from USLTA and adopted that Article as a free standing Act. (R. Rev. Stat. Neb. Section 52-125ff. 1984).

The Construction Lien Drafting Committee, in consultation with the Joint Editorial Board of the Uniform Real Property Acts and with various other interested parties, prepared the present Act. The Joint Editorial Board is composed of members of the National Conference, the American Bar Association, and the American College of Real Estate Lawyers. It has jurisdiction over a number of Conference Acts dealing with real estate matters, including the Uniform Condominium Act, the Uniform Planned Community Act, the Uniform Common Interest Ownership Act, the Uniform Land Transfer Act, the Uniform Simplification of Land Transfers Act, and the Uniform Land Security Interest Act.

While the present Act, as noted, is essentially the same as Part 5 of the Uniform Simplification of Land Transfers Act, there are some significant changes. The most significant change is the addition in this Act of trust fund provisions which create a trust of which construction lien claimants are beneficiaries in certain funds of owners and contractors. Those provisions are contained in Section 501 of the Act and will be further discussed at the end of this prefatory note.

All states presently have mechanics' lien laws. Those laws present an extraordinarily varied approach, in substance, and in language, to the issues involved in mechanics' lien legislation. In fact, variation among the states may be greater in this area than in any other statutory area. In an era of national lenders and suppliers and of many multistate builders, the variation among the states as to mechanics' lien matters is a substantial impediment to an efficient mortgage and real estate market. Furthermore, the present priority and owner liability rules present difficult problems for contractors, owners, lenders, and courts, and add substantial expense and risk to many real estate transactions. Therefore, significant benefit could be gained from the widespread adoption of a uniform mechanics' lien act.

This Act is, it will be noted, titled "Uniform Construction Lien Act." This title, suggested by a Wisconsin modification of its mechanics' lien laws, is adopted because the title "Mechanics' Liens" improperly implies that laborers are the primary beneficiaries of mechanics' lien laws. With the payment of wages weekly or bi-weekly by contractors (as is the universal custom today) wage claimants no longer loom large in mechanics' lien situations.

The basic structure of this Act and its predecessor owes much to the Florida mechanics' lien law which was adopted in 1963. For example, the dating of the lien claimant's priority from the time of recording a "notice of commencement" covering the construction project is a feature of the Florida legislation.

While there is great diversity in mechanics' lien laws, they deal with common issues, and tend to fall into a limited number of patterns on each of the major issues involved. These major issues are listed below and will be considered in this introductory note: (1) who may secure a construction lien; (2) is the owner protected in making payments to the prime contractor if, at the time he pays, he has no notice of a construction lien claimant below the prime; and (3) from what time does the mechanics' lien take priority over third party buyers, mortgagees, or levying creditors who deal with the real estate.

Who May Secure a Lien?

Mechanics' lien statutes give liens against the real estate being improved to persons who supply services (including labor) and materials for the improvement. In about half the states, any person who supplies services or materials is allowed a lien, no matter how far removed he is from the owner. Other states limit those who can secure a lien to two tiers (prime contractor, subcontractor), three tiers (prime contractor, subcontractor, sub-subcontractor) or four tiers. A few others allow a lien to two tiers plus all materialmen and laborers, and one gives a lien to all who contract with licensed contractors. In this Act, liens are allowed to any person who furnishes services or materials pursuant to a real estate improvement contract, no matter how far removed he is from the contracting owner.

This Act follows many present mechanics' lien laws in allowing a lien to suppliers of materials only when they have in some way indicated that they sell with the belief that the materials are to be used on the particular real estate improvement project. Therefore, a supplier who delivers materials to a contractor without knowing the particular real estate on which the materials are to be used cannot later claim a lien on the real estate on which the materials were actually used. Most present acts give a lien to a materialman only if the materials are delivered to the site. This Act relaxes that requirement somewhat and allows a lien if seller's belief that the goods are to be used on a particular site is evidenced either by a notation on the sales contract, by a delivery order, or by actual delivery to the site.

However, except with respect to materials specially fabricated for the particular real estate and not salable in the ordinary course of the materialman's business, a materialman gets no lien unless the materials are actually used in the making of the improvement. A lien is given to

persons who supply materials such as gasoline, which are consumed in the course of the improvement, and also to lessors of machinery and tools used in making the improvement.

Preparation of plans, surveys, and architectural or engineering plans are improvement contracts for which a lien is allowed. Therefore, surveyors, architects, engineers and others who prepare such surveys and plans are allowed liens on the real estate involved whether or not the planned improvement is actually made.

Priority Over Third Parties

Most mechanics' lien laws date the lien claimant's priority over third parties from the time of "commencement" or "visible commencement" (hereafter both statements of the rule are referred to by the use of the word "commencement") of the improvement, provided that the claimant records his lien within a limited period of time after he completes his work on the project. A commencement priority rule makes it difficult for persons who deal with real estate to determine whether it may be subject to subsequently asserted lien claims since a record title examination will not provide the necessary information. That priority rule, in effect, gives the lien claimant a secret lien. The secret lien is of limited duration since all statutes require the claimant to record a notice of lien within a fairly short period of time (2 to 18 or so months after completion) if he is to realize on the lien. Nevertheless, the title difficulties created are substantial.

A commencement priority rule also creates particular difficulties for construction lenders. Such lenders usually record their mortgage at about the time the work is beginning, and, with some regularity, a construction lender discovers that work had commenced prior to the time he recorded so that he is junior to the construction lien claimant. Under the commencement priority rule, careful construction lenders make on-site inspections prior to recording their mortgage and make efforts to preserve evidence that no work had commenced when they recorded. Such efforts involve additional expense and do not guarantee that a court will later agree that recording by the mortgagee predated commencement.

A number of states, in response to the problems created by the commencement priority rule, have fixed other mechanics lien priority dates. A few states date mechanics' lien priority from the time of recording the individual claimant's lien. This system protects the integrity of the real estate records, but prevents a contractor or materialman who furnishes services or materials late in the construction from getting priority equal with that of those who furnish services or materials early. Illinois makes the time the owner and a prime contractor enter into the improvement contract the priority date for that prime and claimants who claim through him. A few states date all claimants' priority from the time the prime contract or a notice thereof is recorded in the real estate records. That system, also, protects the integrity of the public records, but, like the Illinois system, gives claimants under different primes different priorities in cases in which the owner uses more than one prime contractor on an improvement project.

This Act adopts a notice recording device, first developed in Florida, under which the owner, prior to the beginning of work on an improvement, records a "notice of commencement" which puts third parties on notice that construction liens may be claimed against the real estate. If a lien claimant records his lien during the effective period of a notice of commencement, his priority date is the date the notice of commencement was recorded.

The notice of commencement, somewhat like a Commercial Code Article 9 financing statement, need not contain any details concerning the proposed improvement and, if not limited by its terms, protects any person who furnishes materials or services to improve the real estate described in the notice of commencement, whether or not the improvement made was within the contemplation of the owner at the time the notice of commencement was recorded.

The notice of commencement is effective for the time stated therein (but at least six months), or, if no time is stated, for three years, except that the notice is effective for only one year as against a protected party buyer of residential real estate. The owner may, however, terminate the notice of commencement before its expiration date by recording a notice of termination, publishing a copy of the notice, and notifying claimants who have requested notice of a termination. If an owner terminates a notice of commencement, except in connection with stoppage or completion of the work, he is personally liable to construction lien claimants to the extent that his termination prevents realization on a lien.

If a notice of commencement is not recorded, lien claimants take priority from visible commencement of the improvement. There are, however, two exceptions to the visible commencement rule. First, after a notice of commencement is recorded, even though recorded after visible commencement of the improvement, the priority date is the time the notice of commencement is recorded. Second, if a notice of commencement has expired, a claimant cannot get a priority date earlier than the date his lien is recorded, or 30 days after expiration of the notice of commencement, whichever is earlier. If a notice of commencement has not been recorded, a claimant, rather than relying on the rules just stated, may record a notice of commencement which fixes the priority date in the same way that an owner's notice of commencement does.

The notice of commencement system permits third parties to rely on the record and, at the same time, gives all claimants on a particular improvement equal priority no matter how many prime contractors there are and no matter when the particular claimant comes on the job. In cases where construction has taken place without recording of a notice of commencement, a prospective lender or buyer can clear up the situation by having the owner record a notice of commencement and immediately thereafter record a notice of termination. Under the notice of termination procedure, the notice of commencement can be terminated 30 days after it was recorded, but as indicated above, public advertisement is necessary. Therefore, prospective lien claimants are put on notice that they must act promptly to preserve their liens. In that case, lien claimants must come in and record their liens before termination or be deferred to the time they actually record or 30 days after the termination date, whichever is earlier.

Particularly in smaller, owner-financed improvements, it may be uneconomical to record a notice of commencement, and, in such cases, as already noted, claimants are protected by giving them a visible commencement priority date.

This Act follows practically all prior mechanics' lien laws in denying priority over prior mortgages to the construction lien. A few states give the lien priority over the prior mortgage to the extent of the value added to the real estate by the improvement and a few states provide that under the lien the improvement can be sold and removed from the real estate.

Is The Owner Protected In Making Payments To The Prime Contractor, If, At The Time He Pays, He Has No Notice That A Mechanics' Lien Claimant Claiming Under The Prime Has Not Been Paid?

In many states, under present law, an owner cannot with safety pay a prime contractor even though no claimant claiming through that prime contractor has made a demand that he be paid directly by the owner. In those states, the owner takes the risk that a prime contractor or others in the contracting chain will not apply payments received by them to the payment of suppliers of services and materials which will have a lien on the improvement. Possible owner double liability leads, in those states, to elaborate lien waiver or direct disbursement techniques where knowledgeable parties are involved. In other states, the owner is protected so long as he in good faith pays a prime contractor before any demand is made upon the owner for payment by a potential lien claimant.

This Act offers the states two alternatives which continue the two existing patterns. Under the first alternative, an owner's real estate is subject to the liens of claimants below a prime contractor only to the extent that the owner has not paid the prime contractor at the time he receives notice from the claimant of the prospective lien claim. Under the second alternative, a claimant below a prime contractor can assure himself of a lien against the owner for his full contract price by notifying the owner within 20 days after the claimant first furnishes services or materials. If the claimant so notifies the owner, the owner cannot defend that he had already paid the prime contractor at the time he received the notice. The 20-day notice requirement, patterned after the California lien law, however, does give the owner substantial protection against double payment.

If a state wishes to adopt the first alternative, it should enact Alternative A of Section 207. If it wishes to adopt the second alternative, it should enact Alternative B of that section. See the additional comments preceding Section 207, Alternative B.

As noted above, this Act imposes a trust for the benefit of prospective lien claimants in certain assets of owners and contractors. A number of states presently have trust fund provisions similar to those adopted in this Act. The effect of the trust fund provisions are to impose liability for breach of trust on an owner or contractor who fails to use trust assets to pay lien claimants. Such liability would ordinarily include criminal liability and individual liability for agents of the owner or contractor who participate in the breach of trust. The existence of a trust also means

that third parties who claim an interest in the trust assets will lose to the beneficiaries unless they would prevail against beneficiaries under trust law. Therefore, for example, most takers of security interests in a contractor's accounts receivable would lose to lien claimants who are beneficiaries of the trust created by this Act in the receivables.

Trust assets in the case of an owner are money lent to him under a construction mortgage, and proceeds of sales or mortgages made during the construction or thereafter during the period during which a lien could be filed against the property. In the case of contractors, trust assets are the payments and right to be paid under the contract in question.

The Act permits the trustee of the trust to treat himself as a beneficiary of the trust and also permits the trustee to pay trust claims in any order he chooses. It further permits use of trust assets for non-trust purposes, so long as trust assets remaining are sufficient to pay all claims which arise or which are reasonably likely to arise in the future. Those provisions significantly ameliorate the impact of the trust fund rules on the trustee.

UNIFORM CONSTRUCTION LIEN ACT

ARTICLE 1

GENERAL PROVISIONS AND DEFINITIONS

SECTION 101. PURPOSES; RULES OF CONSTRUCTION; SCOPE.

(a) This [Act] shall be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) to simplify, clarify, and modernize the law governing construction liens;

(2) to provide procedures for the protection of persons furnishing services and materials for real estate improvements;

(3) to further the security and certainty of land titles; and

(4) to make uniform the law with respect to the subject of this [Act] among states enacting it.

(b) This [Act] creates, and provides for the attachment and enforceability of, a lien against real estate in favor of a person furnishing services or materials under a real estate improvement contract.

COMMENT

As the Prefatory Note points out, present mechanics' lien laws are so diverse that keeping abreast of them and maintaining the appropriate procedures in the various states require substantial time and expense by multistate owners, lenders, contractors, and subcontractors. A major purpose of this Act is to eliminate that complexity.

The dating of construction lien priority from the time a notice of commencement is filed is a substantial contribution to the certainty of land titles.

The intent of the Act is that a nonconsensual lien for work done on real estate arises only according to the provisions of this Act. It therefore rejects the judicial decisions in some states that "equitable" liens may arise in favor of contractors even though they have failed to comply with applicable mechanics' lien laws. See Comment 1 to Section 201.

SECTION 102. GENERAL DEFINITIONS.

As used in this [Act]:

(1) "Claimant" means a person having a right to a lien upon real estate under this [Act] and includes a successor in interest.

(2) "Common interest community" means real estate described in an instrument with respect to which a person by reason of ownership of a part of the real estate is obligated to pay for real estate taxes or assessments, insurance premiums, maintenance, or improvement of another part of the real estate. The term includes real estate comprising a condominium or cooperative.

(3) "Construction lien" means a lien arising under this [Act].

(4) "Construction security agreement" means a recorded security agreement that contains a legend on the first page clearly stating that it is a "Construction Security Agreement" and that secures an obligation the debtor incurred for the purpose of making an improvement of the real estate in which the security interest is given.

(5) "Contract price" means the amount agreed upon by the contracting parties to be paid for performing services and furnishing materials covered by the contract, increased or diminished by the price of change orders or extras, amounts attributable to amended specifications, or breach of contract, including defects in workmanship or materials. Liquidation

of damages between the contracting owner and a prime contractor does not diminish the contract price as to other claimants. If no price is agreed upon by the contracting parties, "contract price" means the reasonable value of all services and materials covered by the contract.

(6) "Contracting owner" means a person who owns real estate and who, personally or through an agent, enters into a contract, express or implied, for the improvement of the real estate.

(7) "Good faith" means honesty in fact and the observance of reasonable standards of fair dealing in the conduct or transaction involved.

(8) "Judicial proceeding" means action at law or suit in equity, or any other proceeding in which rights are judicially determined.

(9) "Notice of commencement" means the notice specified in Section 301, whether recorded by an owner or by a claimant.

(10) "Notice of termination" means a notice terminating a notice of commencement (Section 302).

(11) "Organization" means a corporation, government, governmental subdivision or agency, business trust, estate, trust, partnership, association, joint venture, or any other legal or commercial entity.

(12) "Person" means an individual or an organization.

(13) "Prime contract" means any real estate improvement contract made between the contracting owner and a prime contractor.

(14) "Prime contractor" means a person who makes a real estate improvement contract with a contracting owner.

(15) "Protected party" means:

(i) an individual who contracts to give a security interest, in or to buy or have improved, residential real estate, all or a part of which the individual occupies or intends to occupy as a residence;

(ii) a person obligated primarily or secondarily on a contract to buy or to improve residential real estate or on an obligation secured by residential real estate if, when the person becomes obligated, that person is related to an individual who occupies or intends to occupy all or a part of the real estate as a residence; or

(iii) with respect to a real estate security agreement, a person who acquires residential real estate and assumes or takes subject to the obligation of a prior protected party under the security agreement.

(16) "Real estate" means an estate or interest in, on, over, or under land, including minerals, structures, fixtures, and other things that by custom, usage, or law pass with a conveyance of land though not described or mentioned in the contract of sale or instrument of conveyance; and, if appropriate to the context, the land in which the interest is claimed. The term includes rents, the interest of a landlord or tenant, and interests in a common interest community.

(17) "Real estate improvement contract" means a contract to perform services or furnish materials for the purpose of producing a physical change in the real estate, including:

(i) alteration of the surface by excavation, fill, change in grade, or change in a shore, bank, or flood plain of a stream, swamp, or body of water;

(ii) construction or installation in, on, over, or under the surface of land;

(iii) demolition, repair, remodeling, or removal of a structure previously constructed or installed;

(iv) seeding, sodding, or other landscaping; and

(v) surface or subsurface testing, boring, or analyzing, or the preparation of plans, surveys, or architectural or engineering plans or drawings for any change in the physical condition of land, whether or not used incident to producing a change in the physical condition of the real estate.

The term does not include (i) a contract to perform services in connection with the financing of a real estate improvement, or (ii) a contract for the exploration, drilling, production, mining, or transportation of oil, gas or other minerals, or removal of timber, gravel, soil, sod, or things growing on land, or other similar contracts in which the activity is primarily for the purpose of realizing upon the disposal or removal of the objects removed, or a contract for the planting, cultivation, or harvesting of crops or for the preparation of the soil for planting of crops.

(18) A person is "related" to:

(i) an individual if that person is

(A) an organization directly or indirectly controlled by the individual, the individual's spouse, or a relative by blood, marriage, or adoption who shares the same residence with the individual;

(B) the spouse of the individual;

(C) a brother, brother-in-law, sister, or sister-in-law of the individual;

(D) an ancestor, descendant, or adopted child of the individual or of the individual's spouse; or

(E) any other relative by blood, marriage, or adoption of the individual or of the individual's spouse if the relative shares the same residence with the individual.

(ii) an organization if that person is:

(A) any other organization controlling, controlled by, or under common control with the organization; or

(B) a person related to the person controlling the organization.

(19) "Residential real estate," in relation to a protected party, means real estate, improved or to be improved, containing not more than [three] acres, not more than four dwelling units, and no nonresidential uses for which the protected party is a lessor. The term includes a unit in a common interest community if the unit is otherwise "residential real estate," regardless of the size of, or the number of units in, the common interest community.

(20) "To record" means to present to the [recording officer] for the place where the land is situated a document that the officer accepts and either enters in a daily log or notes thereon an identifying number or receipt, regardless of whether under applicable law the [recording officer] is directed to file the document or otherwise to maintain a record of it.

"Recorded" and "recording" have corresponding meanings.

(21) "Security agreement" means a writing that creates or provides for a security interest in real estate. The term includes a mortgage or deed of trust.

(22) "Security interest" means an interest in real estate which secures payment or performance of an obligation. If a lease is intended as security to the lessor, the lessor's interest is a security interest. If a seller's retention of legal title to real estate after the buyer enters into possession is intended as security, the seller's interest is a security interest. The inclusion in a lease of an option to purchase at a price not unreasonable under the circumstances at the time of contracting does not of itself indicate the lease is intended for security, and retention of the title to real estate by a seller under a contract right to retain title for not more than one year after the buyer enters into possession of the real estate is not a retention for security.

COMMENT

1. "Claimant." All persons entitled to a lien under this Act are referred to as claimants whether or not they have yet claimed a lien.

2. "Common Interest Community." This definition, adapted from that which appears in the Uniform Common Interest Ownership Act promulgated by the National Conference of Commissioners in 1982, covers condominiums, cooperatives, and other shared interest communities.

3. "Construction lien." Historically, the liens dealt with by this Article have been called "mechanics liens." The term "construction lien" is used in this Act because it is somewhat more descriptive of the situations in which the lien arises.

4. "Construction security interest." Construction security interests are given special treatment in Section 210.

5. "Contract price." Change orders are effective to either increase or diminish the contract price. This definition is particularly important under the alternative provisions of the Act under which the owner is liable to lien claimants only for the portion of the contract price not yet paid to the prime contractor at the time the owner learns of the claim.

6. "Contracting owner." Under this Article, only the interests of persons who have contracted to have their real estate improved are subjected to liens. Therefore, the term "contracting owner" is used throughout the Article to refer to the owner against whose real estate the lien arises. Section 104 states some presumptions as to agency in determining whether an owner is a contracting owner.

7. "Good faith" as used in this Act means observance of two standards: "honesty in fact" and "observance of reasonable standards of fair dealing." The definition is similar to that in Sections 2-103(1)(b) and 7-404 of the Uniform Commercial Code.

8. "Judicial proceeding" is used in this Act instead of "action." It includes proceedings initiated by a complainant and also claims of a defendant, such as matters frequently called recoupment, counterclaim, or setoff. "Proceeding" is the term more frequently used in modern court rules to eliminate any connotation of actions at law or suits in equity.

9. "Notice of commencement." In this Act, provision is made for determining priority between construction lien claimants and third parties by reference to time of recording in the land records a notice of possible liens. This notice is called a "notice of commencement." Lien claimants who record their liens while a recorded notice of commencement is effective take priority from the time it was recorded, rather than from the time of visible commencement of the improvement project. The definition is included to call attention to Section 301 so that, when the reader encounters the term in the Act, it will have immediate meaning.

10. "Notice of termination." A notice of commencement is effective for its stated period (but it cannot state a duration of less than six months) or, if no period is stated, for three years (one year as to a protected party). However, it may be terminated before its stated expiration date or the end of a year, as the case may be, by recording a notice of termination. Therefore, the term "notice of termination" is an important one and, as in the case of the companion term, notice of commencement, a definition is included to call attention to the term early in the Act.

11. "Organization" is intended to include all legally recognized persons other than individuals. It specifically includes governmental entities, trusts, and associations.

13 and 14. "Prime contract," "Prime contractor." Under these definitions there may be a number of prime contracts and prime contractors in connection with a single improvement project.

15. "Protected party." In common with many other recent Acts, this Act contains some provisions which are intended to provide special protection for home owners or home buyers in construction lien situations. The "protected party" is the person who receives that special protection.

The fact that a protected party owns the real estate concurrently with another person, either by tenancy by the entireties, joint tenancy, or tenancy in common, does not affect his protected-party status, whether or not the person with whom he owns the real estate is a protected party.

Occupies as "a" residence instead of "his principal" residence is used intentionally. An individual who has his voting residence in one state or county, a summer residence in another and a winter residence in a third may be a "protected party" in each of the three jurisdictions.

16. "Real estate." The basic definition provides that real estate is the legal relationship (interest) a person has against the world with respect to land. It includes both common law estates and easements and other incorporeal hereditaments. The term is also used, if the context warrants, to refer to the physical object (the land) in which the interest exists. Leaseholds are defined as real estate for the purposes of this Act. However, the treatment of leaseholds as "real estate" is only for the purposes of this Act and is not intended to change other law, such as the law on decedent's estates, under which leaseholds may be treated as personal property.

17. "Real estate improvement contract." Liens under this Act arise for services or materials furnished under a real estate improvement contract (See Section 201). This definition therefore specifies the contracts under which a lien will arise.

A "real estate improvement contract" is a contract for the "purpose of producing a change in the physical condition of land or a structure." However, two types of contracts which result in physical change are excluded from the definition.

The first type is a contract entered into primarily to make available for sale or use things removed from the land or structure. A mining contract would not be a real estate improvement contract, but a contract for the laying of track in a mine or the construction of a slurry line to move ore would be. Under this Act, as just noted, no lien arises for work done under a mining contract or under a contract for such things as drilling an oil well. If a state presently has a separate statute giving a lien for oil and gas extraction activities or similar work, it will probably wish to continue that statute. If a state presently gives a mechanics' lien claim for oil and gas extraction and similar activities, it may wish to amend this Act to cover such activities.

If demolition of a structure is taking place primarily to make the materials of the structure available for sale or use, the demolition contract is not a real estate improvement contract. (Note that under (iii) a contract for the demolition or removal of a structure is a real estate improvement contract unless excluded by the last paragraph of the definition.)

The second type of contract excluded from the real estate improvement contract category is a contract to perform ordinary farming operations. Contracts for such things as farm ponds or roads would be real estate improvement contracts.

Architects, engineers, and surveyors are given a lien against real estate if they prepare plans, drawings or surveys for or of that real estate in connection with an anticipated change in its physical condition. However, if the work is not in connection with an anticipated physical change, the contracting party is not entitled to a lien against the real estate.

It could be argued that certain persons who render ancillary services in connection with improvement projects, such as lenders who provide financing and lawyers who search titles and prepare contracts, are furnishing services for the purpose of producing a change in the physical condition of land. However, the last paragraph of the definition states that a contract to perform services in connection with financing of a real estate improvement is not a real estate

improvement contract. No specific exclusion is made as to attorneys services, but it is not intended that attorneys or others furnishing ancillary services be given a lien.

18. "Related." The definitions of this section are important in determining who is a protected party under definition 15. For example, a corporation is related to an individual if it is under the control of the individual. Under definition 15 a person obligated on an obligation secured by residential real estate occupied by an individual related to him is a protected party. Therefore, a corporation is a protected party if it is obligated on a real estate improvement contract for real property resided in by an individual controlling the corporation.

19. "Residential real estate." Owner-occupied residential real estate also includes real estate in which there are rental units if the debtor resides on the real estate, the real estate contains no more than [three] acres of land, and it contains no more than four units available for housing purposes. A debtor is protected even though there is a commercial use which the debtor operates.

20. "To record" is defined to include the situation where a document not entitled to record is nevertheless accepted by the recorder.

21. "Security agreement" is used rather than mortgage and is a broader term.

22. "Security interest." This definition is similar to the definition of security interest in 1-201(37) of the Uniform Commercial Code.

SECTION 103. NOTICE; KNOWLEDGE; GIVING NOTICE; RECEIPT OF NOTICE.

(a) A person has "notice" of a fact if:

(1) the person has actual knowledge of it;

(2) the person has received a notice or notification of it; or

(3) from all the facts and circumstances known to the person at the time in

question the person has reason to know it exists.

(b) Except as provided in subsection (e), a person has "knowledge" or "learns" of a fact or "knows" or "discovers" a fact only when the person has actual knowledge of it.

(c) A person "notifies" or "gives" or "sends" notice or notification to another, whether or not the other person actually comes to know of it, by taking steps reasonably required

to inform the other in ordinary course. However, particular steps specified by this [Act] to be taken to notify, or give or send notice or notification, must be taken.

(d) A person "receives" a notice or notification when it:

(1) comes to the person's attention; or

(2) is delivered at the place of business through which the person

conducted the transaction with respect to which the notice or notification is given or at any other place held out by the person as the place for receipt of the communication.

(e) Notice, knowledge of a notice, or notification received by a person is effective for a particular transaction at the earlier of the time it comes to the attention of the individual conducting the transaction or the time it would have come to the individual's attention had the person maintained reasonable routines for communicating significant information to the individual conducting the transaction and had there been reasonable compliance with the routines. An individual acting for the person is not required to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

(f) Notwithstanding agreement to the contrary, notices required or permitted to be sent to protected parties under this [Act] must contain a warning statement in [] and in any other language found by the [Commissioner of Banks] to be the principal language spoken by a substantial number of persons engaged in transactions covered by this [Act] as follows: "This is an important notice regarding your rights in real estate. Get it translated immediately."

COMMENT

1. For convenience in understanding, this section contains the provisions specifying when a person "has" notice; when a person "gives" notice; when a person "receives" notice and, in the case of an organization, when notice of an individual is imputed to the organization.

Subsection (c) provides that proper dispatch and not its receipt satisfies the obligation stated in a section as an obligation "to notify" or "to give notice." When the essential fact in the obligation concerning notice is the other party's receipt of notice the fact is stated in the appropriate section. Subsection (d) states when a notice is to be regarded as "received."

2. Under the definition of notice, a person has notice when he has received a notification of the fact in question, but by the last sentence of subsection (e) the Act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as *Graham v. White-Phillips Co.*, 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20 (1935), are not overruled.

3. Subsection (e) makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

SECTION 104. PRESUMPTION OF AGENCY AS TO CONTRACTING OWNER.

For the purpose of determining whether an owner is a contracting owner (Section 102(6)), agency is presumed, in the absence of clear and convincing evidence to the contrary, between employer and employee and between spouses.

COMMENT

Some construction lien laws provide that a lien arises against the interest of noncontracting owners unless they, within a short period of time after they learn of an improvement (several statutes specify ten days), notify the prime contractor that they have no responsibility for the work. Under this Act, no lien arises against the interest of a noncontracting owner. Under this section, however, the burden is shifted to the owner in certain situations to show that the person who made the contract was not acting as his agent.

SECTION 105. SUPPLEMENTARY PRINCIPLES APPLICABLE.

The principles of law and equity, including the law relative to capacity to contract, principal and agent, laches, marshalling of assets, subrogation, estoppel, fraud, misrepresentation,

duress, coercion, mistake, bankruptcy, or other validating or invalidating cause, supplement this [Act] unless displaced by particular provisions of it.

COMMENT

"Validating" and "invalidating" are not intended as narrow words confined to the inception of the transaction, but extend to cover any factor which at any time or in any manner renders or helps to render any transaction or right valid or invalid. Common law rights of marshalling and subrogation are retained.

The listing given in this section is merely illustrative; no listing could be exhaustive. The fact that in some sections particular circumstances have led to express reference to other fields of law is not intended at any time to suggest the negation of the general application of the principles of this section.

SECTION 106. SHORT TITLE.

This [Act] may be cited as the Uniform Construction Lien Act.

SECTION 107. SEVERABILITY.

If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of the [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

COMMENT

This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

ARTICLE 2

EXISTENCE; PRIORITY; BONDS; WAIVER

SECTION 201. CONSTRUCTION LIEN IN GENERAL; REFERENCES TO SECTIONS ON AMOUNT, PRIORITY, AND ENFORCEMENT.

(a) A person who provides services or materials pursuant to a real estate improvement contract has a construction lien to secure payment of the contract price only to the extent permitted in this [Act].

(b) A construction lien may not be enforced under this [Act] unless it is recorded in accordance with Section 303 (Recording Lien) within the time specified in Section 208 (Attachment of Construction Lien; Recording Required).

(c) Real estate to which a construction lien applies is specified in Section 203 (Real Estate Subject to a Construction Lien). Limitations on the existence of a lien for materials are specified in Section 204 (Limitation of Lien for Materials Supplied).

(d) The amount of a claimant's lien is specified in Section 207 (Amount of Construction Lien). The content of the notice of lien liability to be given to the owner under Section 206 is specified in Section 205 (Notice to Owner).

(e) The priority of a claimant's lien as against other construction lien claimants is specified in Section 209 (Priority Among Construction Lien Claimants), and priority as against claimants other than construction lien claimants is specified in Section 210 (Priority of Construction Liens as Against Claims Other Than Construction Lien Claims).

(f) A judicial proceeding to foreclose a lien under this [Act] is governed by Section 401 (Proceeding to Enforce Construction Lien), and must be commenced within the time specified in Section 211 (Duration of Construction Lien; Statute of Limitations).

COMMENT

1. Subsection (a) is the basic operative provision of this Article. It provides that any person who furnishes materials or services under a contract for the improvement of real estate, no matter how far removed from the contracting owner, has a lien against the contracting owner to the extent provided in the Article. This Act does not, as did many prior lien laws, limit a lien to contractors in the first two, three, or four tiers below the owner. A real estate improvement contract is defined in Section 102(17). As defined there, the term is not limited to a contract made by an owner of the real estate. Therefore, a contract made, for example, by a subcontractor with a materialman for materials to be used on the job is a real estate improvement contract. However, a lien arises only against an owner who has entered into a contract to have the work done. If no owner has contracted for the work, there is no lien under this Article whether or not the owner might be liable on unjust enrichment principles for the value of the improvements. Similarly, if a prime contractor engages a subcontractor to do work beyond that contracted for by the owner, the subcontractor has no lien against the owner's real estate for the unauthorized work.

Under this Act a lien arises under a real estate improvement contract only to the extent provided in the Act. The Act, therefore, rejects the holding of cases such as *Gee v. Eberle*, 279 Pa. Super. 101, 430 A.2d 1050 (1980) which grant subcontractors an equitable lien against the owner even though the subcontractor has failed to comply with the provisions of the mechanics' lien laws. It rather supports the result in cases such as *First Federal S & L Ass'n of Chicago v. Connelly*, 107 Ill.App.3d 298, 437 N.E.2d 742 (1982), and *Sesquatahie Concrete Service v. Cutter Laboratories*, 616 S.W.2d 160 (Tenn. 1980) which hold that no equitable lien arises in favor of a lien claimant who fails to perfect his lien under the mechanics' lien statutes.

2. Subsections (b) through (f) catalogue those provisions of the Act which specify the amount, real estate subject to, priority of, and manner of foreclosure of, construction liens. Those references are intended to aid the reader in finding those sections of the Act. The subsections are not intended to have independent substantive meaning, nor do they reduce the effectiveness of sections not referred to.

SECTION 202. GOVERNMENTAL EXEMPTION FROM CONSTRUCTION LIEN.

Real estate owned by the state, a county, a municipality, a governmental agency, or a political subdivision is exempt from a construction lien under this [Act].

COMMENT

1. A construction lien does not arise against real estate owned by a governmental unit or agency. However, the fact that a nongovernmental entity owns real estate jointly with a governmental entity or the fact that a governmental entity has an interest in land in which a nongovernmental entity also has an interest, does not prevent a construction lien from arising against the interest of the nongovernmental entity.

2. This Act does not provide for payment bonds or other procedures protective of subcontractors and materialmen in real estate improvement contracts made by governmental entities. If a state which adopts this Act presently has in its mechanics' lien laws bonding, stop-notice, or similar statutory provisions for public construction contract cases, it should continue those provisions in a separate act.

SECTION 203. REAL ESTATE SUBJECT TO CONSTRUCTION LIEN.

(a) Real estate to which a recorded construction lien applies is:

(1) if a notice of commencement was recorded before the recording of the construction lien, the real estate described in the notice of commencement; or

(2) if a notice of commencement was not recorded before the recording of the construction lien, the real estate of the contracting owner being improved or directly benefitted, except as provided in subsection (b).

(b) If a claimant who recorded a lien while there was no recorded notice of commencement covering the real estate later records a notice of commencement, the lien is on the contracting owner's real estate described in the notice of commencement.

(c) A claimant's lien on a contracting owner's real estate includes the value of services and materials provided under a real estate improvement contract with that owner for improvements directly benefiting, but not located on, that owner's real estate.

(d) If a recorded notice of commencement covers more than one lot in a platted subdivision of record, a claimant may apportion the claimant's construction lien to the various lots covered by the notice of commencement in any proportion the claimant chooses and states in the claimant's recorded construction lien and may assign all of the lien to a particular lot.

(e) If a recorded construction lien does not contain an apportionment as provided in subsection (d), the owner may demand the claimant to make an apportionment. If the claimant

does not make an apportionment within 30 days after the demand, by recording an amendment of the recorded lien, the owner may make a good faith apportionment by recording an owner's statement of apportionment (Section 309). The apportionment is conclusive in favor of a person acquiring an interest in the real estate after the statement of apportionment is recorded, even if the owner did not give the notice to apportion referred to in this subsection or for any other reason was not entitled to record a statement of apportionment, or did not make a good faith apportionment.

(f) Except as expressly provided in [cite reference to state statutes governing condominiums and other common interest communities], a construction lien arising under this [Act] by reason of an improvement to real estate that is part of a common interest community does not attach to the common elements, but attaches to the units as follows:

(1) if the improvement was contracted for by the association of unit owners, however denominated, the lien attaches to all the units in the common interest community for which the association acts, unless the association notifies the claimant, when the contract is made, that the lien may attach only to the units on or for the benefit of which the improvement is being made; and

(2) if the improvement was contracted for by a unit owner, the lien attaches only to that owner's unit.

(g) Except as provided in subsection (d), if a construction lien attaches to two or more units in a common interest community, the unit owner of an affected unit may pay to the claimant the amount of the lien liability attributable to the owner's unit, and the claimant, upon receipt of payment, promptly shall deliver a release of the lien covering that unit. The amount of

the payment must be in the proportion the unit owner's common-expense liability bears to the common-expense liabilities of all unit owners whose units are subject to the lien. After payment, the association may not assess or have a lien against that unit owner's unit for any portion of the common expenses incurred in connection with the lien.

COMMENT

1. This section deals with the geographic or spatial extent of a construction lien. If a notice of commencement is effective as to the improvement when the lien is recorded, the lien is on the real estate described in the notice of commencement. Therefore, an owner making improvements on a tract which he owns may, in his notice of commencement, limit the real estate against which a lien will arise to that particular real estate on which the improvement is being made. If, for example, a 100,000 square feet building is being built on a portion of a 40-acre tract, the notice of commencement could limit the lienable real estate to the 100,000 square feet on which the building sets and the surrounding land on which related work will be done. If, however, in a case in which there is a recorded notice of commencement describing a limited part of a single tract and improvement work outside the described part takes place, that work is not covered by the notice of commencement since the notice of commencement can apply only to the real estate described therein. If, in the case of the 100,000 square feet building, the notice of commencement described 200,000 feet square with the building in the center and, as a part of the construction, an access road and sidewalks were built on owner's real estate outside the described 200,000 square feet, the lien arising for the road and sidewalks would not be covered by the notice of commencement. In that case, under subsection (b), the lien for the work on the roads and sidewalks would be "on the contracting owner's real estate being improved or directly benefitted." Under that language, a court might decide that all the owner's 40-acre tract was being "directly benefitted" and allow a lien for the sidewalk and road improvements to be claimed against the entire tract. Therefore, the owner recording or notice of commencement should be sure that it does cover all the real estate on which work will actually be done.

2. As just indicated, if no notice of commencement covers a particular improvement at the time that a lien is recorded, the lien arises against the "contracting owner's real estate being improved or directly benefitted." Under that test, if a 100,000 feet building is being built on a 40-acre tract, the finder of fact must determine what part of the 40-acre tract is being improved or directly benefitted. In such a determination, the relationship of the land on which the building is located to the rest of the tract, including use, status of title, and relative values would be relevant. If, for example, a peanut storage warehouse is built on a tract which otherwise contains an automobile service station and a dwelling house, it might be appropriate to conclude that the portions of the tract on which the service station and house are located are not being improved or directly benefitted by the erection of the storage warehouse. On the other hand, if the entire tract is devoted to various peanut storage and processing activities, it might be appropriate to conclude that the entire tract is being improved or directly benefitted.

The uncertainties of the "real estate being improved or directly benefitted" test can easily be avoided by recording a notice of commencement which does describe all the real estate on which actual physical change will occur. Because of the ease with which owners can avoid the problem of identifying the real estate being improved or benefitted, it may be appropriate to resolve doubts on the issue in favor of lien claimants.

A claimant's recorded lien must describe the real estate against which a lien is claimed (Section 303), and, if a claimant claims less than that which he would be entitled to claim under this section, he may be precluded from asserting a larger claim as against persons who have relied on the more limited claim made in his recorded lien.

3. Under Section 301, if the owner has not recorded a notice of commencement, any claimant may record one, and, in that case, the notice of commencement may include as the real estate subject to liens "all or part of the owner's real estate being improved or directly benefitted." (Section 301(j)). Under that language, the claimant might describe all the tract on which the improvement is being made or a part of it. However, in either case, there is some risk that he will be held to have included within the description some real estate which is not being improved or directly benefitted. Since the claimant recording is for the benefit also of other claimants, the other claimants should be able to rely on the real estate described in the notice, and that is the rule stated in subsection (1). However, the claimant who recorded the notice of commencement may lose his lien and be liable to the owner for any damages caused if he in bad faith overstated the real estate being improved or benefitted. (See Section 403(b).) If the amount of real estate being improved or benefitted is overstated but without bad faith, the notice is effective as to all the real estate described.

4. The owner may reduce the real estate covered by a notice of commencement by recording a notice of termination as to the real estate which he wishes to remove from the notice of commencement. In that case, the owner must comply with all the requirements set out in Section 302 for an effective notice of termination. If the owner complies with Section 302, the reduction in real estate covered is fully effective as to all lien claimants who failed to record a lien prior to the effective date of the notice of the termination.

5. A claimant may record a lien at any time after he enters into the contract under which the lien arises, and, also, as already indicated, if a notice of commencement covering the improvement has not previously been recorded by the owner or another claimant, he may record a notice of commencement. If the claimant first records a lien and then records a notice of commencement, the real estate against which his lien arises is, according to subsection (c), controlled by the notice of commencement. If, after a claimant records a lien, the owner or another claimant records a notice of commencement, the notice of commencement has no effect on the real estate subject to the already recorded lien.

6. Under subsection (d), a lien arises against an owner's real estate for improvements made on land not owned by him if the work is part of an improvement on his real estate or directly benefits it. For example, work on streets in a subdivision contracted for by the developer

after the streets had been dedicated to public use would create liens against the developer's land being benefitted by the improvements. Similarly, the construction of a drainage ditch or water line across neighboring privately owned property would result in a lien against the contracting owner's real estate being improved or directly benefitted. If a notice of commencement had been recorded describing the general improvement as a part of which the off-site work is done, the notice of commencement applies to the off-site work so that the priority of the lien and the extent of real estate covered by the lien is determined by the notice of commencement. If no work on the owner's real estate is being done in connection with the off-site improvement, the owner may record a notice of commencement and should describe therein his real estate being benefitted by the improvement.

7. A subdivision developer, in recording a notice or notices of commencement, may group the lots in the notice or notices any way he chooses. For example, he might record a notice of commencement for each lot or for each block. If he records more than one notice of commencement for the subdivision, claimants will have to establish which of the notices of commencement covers their work. To do that, claimants would have to show how much of their materials or services went into the particular real estate covered by each separate notice of commencement. Because of the difficulties which that could involve, claimants may wish to determine precisely what the notice of commencement situation is before they enter into improvement contracts in a subdivision.

If a notice of commencement covers more than one lot in a platted subdivision, claimants may apportion their lien among the lots covered by the notice in any proportion they choose. If, for example, a developer has recorded a separate notice of commencement for a six-lot block and subcontractor Y has contracts totaling \$15,000 in connection with construction on those six lots, he could either apportion all his claim to a single lot or allocate among some or all of the lots in any way he chooses. He may, for example, apportion his entire claim to the lot he believes is most likely to sell first, or to the one he believes to be most valuable, etc. The fact that assertion of the lien against the lot first to sell may cause financial difficulty for the project may, of course, lead the claimant to exercise caution in trying to advance his interests at the expense of the owner. If a claimant does not apportion, his lien is on all the lots just as if they had not been platted. However, under marshalling concepts, third parties may be able to force the claimant to go against lots still owned by the contracting owner or first against lots last sold. See G. Osborne, *Mortgages*, § 286 (1970).

If the claimant does not apportion, the owner, under subsection (e), may demand that the claimant apportion, and, if he does not, the owner may do so. If the owner apportions, he must do so in good faith. Good faith apportionment should not require that the owner apportion some of the claim to every lot, or that he attempt to approximate the percentage of work done by the claimant on each lot, but it would require that he not apportion in such a way that the real estate apportioned to the claim provides inadequate security for it unless the inadequacy would have existed in the absence of apportionment. Even an unauthorized or bad faith apportionment by an owner is conclusive in favor of purchasers who acquire interests after the apportionment.

Subsections (d) and (e) apply only if a notice of commencement has been recorded. If liens are recorded against a subdivision development before a notice of commencement has been recorded, the lien arises against all the owner's real estate being improved or directly benefitted, and there is no right in either the owner or the claimant to apportion the lien among the various lots.

8. Subsection (f) strikes a balance between the interests of unit owners and construction lien claimants when the lien arises for work done on real estate which is part of a condominium or other common interest community. The first rule of the subsection is that the lien does not attach to the common elements. If, for example, the association contracts for work to be done on a swimming pool or parking lot which is a common element, the lien claimant has no power to assert a lien on the swimming pool or parking lot and have it sold to satisfy the lien. Rather the lien attaches to all the units in the common interest community. It, therefore, becomes a fractionalized lien against each unit for that unit's proportional share of the cost. While the result is cumbersome for the lien claimant on the one hand, on the other hand it gives the claimant a lien against the real estate with real value. If a lien were to arise only against the swimming pool or parking lot, in many cases, they would have no value to anyone but the common interest community and could not produce a sales price sufficient to pay the lien claim.

The rule stated in subsection (f) as to the real estate subject to a construction lien takes precedence over the otherwise applicable rule that the property subject to the lien is that described in the notice of commencement or that being improved or directly benefitted. Therefore, if a notice of commencement covering work contracted for by an association describes only the common elements, the lien would, nevertheless arise against all the units. However, the notice of commencement would control the priority date of the construction lien claimants as against third parties. Associations which intend for the lien to arise against all units should describe the entire common interest community in the notice of commencement, though the notice of commencement could also be limiting by stating that, for example, it applies only to work on the swimming pool.

If the association intends to limit the lien claimant to units being improved or directly benefitted by the work, the notice of commencement should be appropriately limited.

Under Section 301 the notice of commencement is required to state the name of the "fee simple title holder" if other than the contracting party. In the case of common interest communities other than cooperatives that will require attaching a list of unit owners to the notice of commencement. In the large condominium, that may be such a burden as to make it unwise to attempt to file a notice of commencement for all but the largest improvement projects.

Similarly, under Section 303, a construction lien claimant, when recording a lien, must name the owners against whom a lien is claimed. In many cases, securing a lien against the individual unit owner under this Act will be so small a benefit to the prospective claimant that it will not be worth its while to gather the necessary information to make the recording. Many condominium acts make any judgment against the Association a lien against the units and

dischargeable by unit owners according to rules similar to those stated in subsection (f). Since the lien attaches to all units as of the time of judgment is entered, it is very unlikely that the lien claimant would be harmed by having its priority date from time of judgment rather than from visible commencement or from time of recording a notice of commencement. That is, under the scheme of common interest acts, a third party who has contracted with the unit owners association in a common interest community is not subject to the risk that a subsequent buyer of a unit will cut off the right to assert to lien against the unit - the judgment attaches to the unit whoever is owner at the time the judgment is entered. Also, the relevant common interest ownership act may permit lien claimants, including mechanics' lien claimants, to effectively record against units by naming only the association. This Act should not be viewed as repealing any such provisions.

If an individual unit owner contracts for an improvement either on his own unit or elsewhere, the lien is only on his unit. In that case, the notice of commencement and recording of lien rules would apply as if the unit were any other individually owned parcel.

SECTION 204. LIMITATION OF CONSTRUCTION LIEN FOR MATERIALS

FURNISHED.

(a) A construction lien for furnishing materials, including tools, appliances, and machinery, arises only if:

(1) they are furnished with the intent, shown by the contract of sale, the delivery order, delivery to the site by the claimant or at the claimant's direction, or by other evidence, that they be used in the course of construction of, or incorporated into, the improvement in connection with which the lien arises; and

(2) they are:

(i) incorporated in the improvement or consumed as normal wastage in construction operations;

(ii) specifically fabricated for incorporation in the improvements and not readily resalable in the ordinary course of the fabricator's business even though not actually incorporated in the improvement;

(iii) used for the construction or for the operation of machinery or equipment used in the course of construction and not remaining in the improvement, subject to diminution by the salvage value of those materials; or

(iv) tools, appliances, or machinery used on the particular improvement, but a lien for furnishing tools, appliances, or machinery used on the improvement is limited by subsection (c).

(b) The delivery of materials to the site of the improvement, whether or not by the claimant, creates a presumption that they were used in the course of construction or were incorporated into the improvement.

(c) A construction lien arising for furnishing tools, appliances, or machinery under subsection (a)(2)(iv) is limited as follows:

(1) if they are rented, the lien is for the reasonable rental value for the period of actual use and any reasonable periods of nonuse taken into account in the rental contract; and

(2) if they are purchased, the lien is for the price but arises only if they were purchased for use in the course of the particular improvement and have no substantial value to the purchaser after the completion of the improvement on which they were used.

COMMENT

Liens arise for materials only if they are supplied with the intention that they be used in the course of a particular improvement project. For example, a lumber dealer who sells lumber to a contractor without knowing which of several jobs the contractor is purchasing the lumber for has no lien, even though he may be able to establish that the lumber was in fact, used on a particular project. Also, even though the seller expects that the materials are to be used on a particular job and made the sale on that assumption, he has no lien unless his materials were in fact used in that improvement. The one exception to the requirement that the materials be used in the particular improvement is for things specially fabricated for the improvement and not

readily resalable by the fabricator in the ordinary course of his business. Under subsection (b), the seller's burden of proof as to use in connection with a particular improvement is eased by a presumption that materials delivered to a site were used in connection with the improvement at that site.

Under subsection (a)(2)(iii) a lien arises in favor of suppliers of oil, gasoline, electricity, water, etc., used in connection with an improvement project if the seller supplied them with the intention that they be used in the particular improvement project.

Under subsection (a)(2)(iv) and subsection (c) a lien arises in favor of a person renting or selling tools, machinery, or appliances used on the project. Of course, as in the case of other suppliers, the lien arises only if the tools, etc., are supplied with the intention that they be used on the particular improvement project. In the case of rentals, the lien is for the reasonable rental value of periods of actual use and reasonable periods of nonuse. Under that test, a lessor will not be able to assert a lien for his full contract price if it includes a charge for unreasonably long nonuse periods.

A lien arises in favor of a seller of tools, machinery, or appliances only if they have no substantial value to the claimant after the completion of the improvement. The idea is of the "consumable tool" or machine which is used up on the job in the same way as lumber or gasoline. A tool or machine may have no substantial value to the claimant at the end of the project either because it is impracticable to move it to another job, or because the claimant reasonably makes no effort to see that the tool or machine is returned to him at the end of the project. For example, in the case of small hand tools, a contractor may have a supply on the job and make no effort to see that tools still usable at the end of the job are returned to him. If, in such a case, the costs of recovery would approach or exceed the value of the tools, it may be appropriate to conclude that they have no substantial value to the purchaser.

SECTION 205. NOTICE TO OWNER.

(a) At any time after entering into a real estate improvement contract, a claimant may give a notice of lien liability to the contracting owner. The notice of lien liability must be in writing, state that it is a notice of a right to assert a construction lien against real estate for services or materials provided or to be provided in connection with improvement of the real estate, and contain:

(1) the name of the claimant and the address to which the owner or others may send communications to the claimant;

- (2) the name and address of the person with whom the claimant contracted;
- (3) the name of the owner against whom a lien is, or may be, claimed;
- (4) a general description of the services and materials provided or to be provided;
- (5) a description sufficient to identify the real estate against which the lien is, or may be, claimed;
- (6) a statement that the claimant has recorded a lien and the date of recording or, if the lien has not been recorded, a statement that the claimant is entitled to record a lien;
- (7) the amount unpaid to the claimant for services or materials, whether or not due, and if no amount is fixed by the contract, a good faith estimate of the amount designated as an estimate; and
- (8) the following statement in type no smaller than that used in conveying the information required by paragraphs (1) through (7):

Warning. If you did not contract with the person giving this notice, any future payments you make in connection with this project may subject you to double liability.

(b) A claimant may notify the contracting owner, either in the notice of lien liability or separately, that the claimant must be notified of the recording of any termination of the notice of commencement. The notice to the owner must be in writing and, if not part of the notice of lien liability, must contain the information specified in paragraphs (1) through (5) of subsection (a). The notice must also state that a written notice of the recording of a notice of

termination must be given to the claimant at least 21 days before the effective date of the notice of termination.

(c) If the contracting owner has held out another person as contracting owner by naming that person in the notice of commencement or otherwise, a notice directed to and received by that person is effective against the contracting owner.

(d) If the contracting owner has held out a fictitious or nonexisting person as contracting owner by naming that person in the notice of commencement or otherwise, a notice to that fictitious or nonexisting person delivered at an address held out by the contracting owner as the address of the fictitious or nonexisting person is effective against the contracting owner.

COMMENT

1. Under both alternatives of Section 207 (which states the amount of an owner's lien liability), a delay by a claimant in giving notice to the contracting owner may result in total or partial loss of his lien. Therefore, under this section, a claimant is entitled to give a notice of liability to the owner as soon as the claimant enters into the contract under which the lien may arise.

2. Under Section 207, the notice of lien liability is not effective against the owner until received by him. Since receipt is the critical event, the Act does not specify any particular method of sending. The claimant is free to use whatever method is most likely to result in prompt receipt by the owner.

3. The notice, to be effective as against the owner, must contain the information specified in subsection (a)(1) through (8). Under the Act, a lien arises in favor of persons who furnish services or materials, no matter how far removed they are from the owner. Remote claimants need only state the name of the person with whom they contracted: they do not have to supply the names of the contracting parties in the contracting chain going back to the owner.

Only a general description of the services or materials furnished need be provided. For example, a statement by a plumbing subcontractor that his services are "installation of plumbing fixtures, pipes, and connections" or even "plumbing contractor" should be sufficient.

The real estate description need not be a metes and bounds or "deed" description. It merely need be sufficient to enable the owner to identify the real estate against which a lien is claimed.

If the claimant has entered into a fixed price contract which covers only the improvement in connection with which he asserts the lien, he should state the contract price less payments already made to him as the amount unpaid. If the contract is not a fixed price contract, the claimant need only make a good faith estimate of the amount which will be due to him on completion. If the contract is fixed price, but covers several different jobs which are not separately priced in the contract, the claimant must make a good faith apportionment to the particular job in connection with which he is giving the notice. Such an apportionment would be an estimate and should be designated as such.

The warning language set out in subparagraph (8) must appear on all notices of lien liability.

4. If a claimant wishes to be notified individually if the owner records a notice of termination, he may give the owner the notice referred to in subsection (b).

5. Sometimes corporate groups may use fairly indiscriminately the names of the various corporate entities. A case in which a claimant has been misled as to the particular corporate entity which is the contracting owner is one of the cases covered by subsection (c). Similarly, a corporation may contract under a name which is not its registered name, or an individual may contract as a corporation. These situations are among those covered by subsection (d).

[SECTION 206. WRITTEN CONTRACT AND DISCLOSURE REQUIRED FOR
CONSTRUCTION LIEN AGAINST REAL ESTATE OF PROTECTED PARTY.]

No construction lien arises under this [Act] as to real estate owned by a protected party unless the real estate improvement contract is in writing, is signed by the contracting owner, and includes the following notice conspicuously on its first page:

Notice. By signing this contract you are subjecting your real estate to the provisions of the [Enacting State's] Uniform Construction Lien Act and to the risk of a forced sale to enforce payment for services or materials.]

COMMENT

It is reasonable to assume that many homeowners do not realize that contractors who make repairs or improvements to their home automatically receive a lien against the home for the price. This section provides some protection to homeowners by denying a lien unless the owner has been given the warning notice specified.

ALTERNATIVE A

[SECTION 207. AMOUNT OF CONSTRUCTION LIEN.

(a) Subject to subsections (b) and (c):

(1) the construction lien of a prime contractor is for the unpaid part of the contract price; and

(2) the lien of a claimant other than a prime contractor is for the lesser of:

(i) the amount unpaid under the claimant's contract; or

(ii) the amount unpaid under the prime contract through which the claimant claims when the contracting owner receives the claimant's notice of lien liability (Section 205).

(b) The construction lien of a claimant is reduced by the sum of the liens of claimants who claim through the claimant.

(c) If a contracting owner's construction lien liability under a particular prime contract (subsection (d)) is less than the sum of claims of all claimants claiming through that particular prime contractor:

(1) claimants whose liens attached at different times have liens in the order of attachment until the owner's lien liability is exhausted; and

(2) among claimants whose liens attached, or may attach, at the same time, each lien is for the claimant's proportional amount of the contracting owner's lien liability to those claimants.

(d) A contracting owner's construction lien liability under a prime contract is the prime-contract price less payments properly made on the prime contract. A payment is properly made on a prime contract to the extent that the payment:

(1) is made in good faith before the receipt by the contracting owner of a notice of lien liability (Section 205); or

(2) if made after receipt by the contracting owner of a notice of lien liability, is made in good faith and leaves unpaid a part of the prime-contract price sufficient to satisfy the unpaid claims of all claimants who have given notice of lien liability and whose claims are not being satisfied by the payment.]

COMMENT

1. Following are some examples which indicate the operation of the rules stated in this section.

Example 1. Owner has contracted with prime contractor for construction at a price of \$100,000. After the owner has paid the prime \$80,000 under the contract, the owner receives notice from subcontractor A that A is owed \$10,000. Owner pays prime another \$10,000 but reserves \$10,000 to pay A. Before owner actually pays A, he receives notice from subcontractor B that he, too, is owed \$10,000 by prime. A notice of commencement is effective as to the improvement so that A and B's liens attach at the same time. Subcontractors A and B each have a lien for \$5,000.

The applicable sections are (c) and (d). Since the owner's payments were either made before notice from a lien claimant, or were made afterward but withholding enough to pay all claimants who had notified, he had properly paid \$90,000. Therefore, under (c) the lien of each claimant is for his pro rata portion of the owner's total lien liability.

Under the system adopted in the statute, a subcontractor cannot assure itself that it will be paid merely by giving notice to the owner since the owner need only withhold from the prime contractor sufficient funds to pay claims he has been notified of and since, if other claimants then notify the owner after further payments have been made to the prime, they share in the withheld funds. The subcontractor can try to get the owner to pay immediately to the subcontractor, or it can ask that other subcontractors also give notice to the owner so that additional funds will be

withheld from the contractor. (The trust fund provisions of this Act (Section 501) makes it likely that the prime will in fact pay over to subcontractors the amounts due them out of contract receipts.)

Example 2. Same as Example 1, except that owner pays \$15,000 to prime after having been notified of subcontractor A's claim. A and B still have a lien of \$5,000 each. Owner's payment to prime was not properly made to the extent that it reduced the remaining contract price due below the claim of subcontractor A.

Example 3. Same as Example 1, except that owner in addition to the payment to the prime contractor pays \$5,000 to subcontractor A before receiving notice of subcontractor B's claim. Owner has, therefore, properly paid \$95,000 and has a total lien liability of only \$5,000. Subcontractor A has a lien of \$5,000 (one-half of his \$10,000 claim having been paid) and subcontractor B has a lien claim of \$10,000, but, since this is greater than the owner's lien liability, subsection (c) comes into play, and subcontractor A receives one-third of \$5,000 (the owner's lien liability) and subcontractor B receives two-thirds.

(Note that in all of the above examples, the prime contractor has no lien because of subsection (b).)

Example 4. Owner has contracted with prime for construction at a price of \$100,000. When the owner has paid the prime \$80,000 under the contract, the owner receives notice from subcontractor A that A is owed \$10,000. He then receives notice from sub-subcontractors one and two that subcontractor A owes them \$3,000 and \$2,000 respectively, a notice from subcontractor B that he is owed \$10,000, and from sub-subcontractor three, who contracted with subcontractor C (who has been paid in full) that he has a claim for \$10,000. Owner does not pay out any additional money to prime. A notice of commencement was recorded as to the improvement so that all claimants have equal priority. A has a lien of \$5,000 (\$10,000 reduced by the total of the liens of those who claim through him), B has a lien for \$10,000, one has a lien for \$3,000, two for \$2,000, and three for \$10,000. Therefore, the total of the lien claims is \$30,000, but, since that is greater than the owner's total lien liability of \$20,000, each claimant's lien is reduced by one-third (each receives his pro rata part of the owner's total liability).

Example 5. Owner has contracted with prime for construction at a price of \$100,000. When owner has paid the prime \$90,000, owner receives a notice of lien liability from supplier claiming that subcontractor D has not paid \$10,000 for which supplier asserts a lien. Prime has paid subcontractor D in full. Supplier has a \$10,000 lien, and owner should pay supplier rather than prime. Prime will have to undertake to recover \$10,000 from D and, if he is unable to do so, will suffer a loss of \$10,000.

In all of the above examples, it has been assumed that owner will pay the amount of the construction liens to protect his real estate. If the owner does not pay, the claimant's remedy is to foreclose against the real estate. In that event, if there are prior encumbrances against the real estate, there may be no recovery for the lien claimants. If the sale produces some money for the

lien claimants but not enough to pay all claims, the money received is distributed to claimants according to the priority rules of Section 208.

2. The owner's liability to a prime contractor is reduced by the amounts the owner pays to claimants claiming through that contractor. While the statute does not explicitly state that payments made by an owner to discharge liens of claimants other than the prime contractor go toward reducing the owner's contractual liability to the prime, it does state that the lien of the prime is reduced by the sum of the liens of claimants who claim through him. The clear implication of that rule is that the owner's personal liability to the prime is also discharged. Similarly, if the owner pays to the prime sums which do not reduce the owner's lien liability to claimants through that prime, the payments could be recovered back from the prime.

As noted in Example 4 above, if a prime contractor pays a subcontractor who in turn fails to pay a sub-subcontractor or materialman, the risk of that nonpayment is on the prime. If the owner pays the sub-subcontractor or materialman to discharge a lien or to prevent a lien from arising, these payments reduce his liability to the prime. Therefore, some prime contractors may wish to engage in policing activities to assure themselves that all participants in the project below them are paid.

3. Section 209 states that, as among lien claimants, all liens attaching at the same time have equal priority, but that liens which attach at different times have priority among themselves in the order of attachment. Under Section 208, liens recorded while there is no effective notice of commencement covering a project take priority as of the earlier of recording or visible commencement, while liens recorded after recording of a notice of commencement take priority as of the time the notice of commencement was recorded. Therefore, in cases where a lien claimant records and subsequently a notice of commencement is recorded as to the project, that claimant will have priority over claimants who record after the notice of commencement is recorded. The following example indicates how the rules of those sections apply in relation to the rules as to owner liability stated by this section.

Example. Owner undertakes an improvement project without recording a notice of commencement. Before a notice of commencement is recorded but after visible commencement, subcontractor A records a notice of lien. His priority date is, therefore, time of visible commencement (Section 209). Thereafter, a notice of commencement is recorded covering the improvement. Then subcontractor B records a notice of lien. Subcontractor B's lien has priority as of the date of recording the notice of commencement. Subcontractor B then gives owner a notice of lien liability claiming \$10,000. Owner pays subcontractor B before subcontractor A notifies owner that he has a \$10,000 lien claim.

Subcontractor A's lien attached first, and, in that case, subcontractor B's lien is subordinate to that of subcontractor A because, under subsection (c)(i), "lien claimants whose liens attach at different times have liens in the order of attachment until the owner's lien liability is exhausted." The owner's lien liability is only \$10,000, and payment to subcontractor B exhausts that liability. Therefore, even though A recorded first, he would, in effect, lose his lien

claim because owner properly paid B. If, however, before owner paid B, owner also received a notice from A that A was owed \$10,000 owner is put on notice of the claims of both A and B and would be obligated to pay them according to their priority position. If, for example, owner paid \$5,000 to each, owner would nevertheless be liable to A for the additional \$5,000 due to A because of A's priority over B.

As the last example indicates, an owner who has received notice from several lien claimants cannot always assume that they are entitled to pro rata distribution of money still due the prime. That will be true only if all who have notified have equal priority. If none of those who have notified have recorded, the owner may make pro rata distribution without any risk since, by making the payment, he will have entirely discharged his lien liability and any subsequent recording will not affect his liability. If some claimants who have notified the owner have recorded and some have not, the owner should be able to pay all claimants pro rata and discharge his liability if those claimants who have not recorded could, by recording, gain equal priority with those who have previously recorded. If those claimants who have not recorded could not gain equal priority, the owner could discharge his lien liability by paying, to the extent of his liability, those claimants with priority.

Alternative B of Section 207

Alternative B of Section 207 is offered for states which wish to impose liability on owners greater than that imposed by Alternative A.

The National Conference of Commissioners on Uniform State Laws takes the position that an owner should not be liable to a lien claimant other than the prime contractor except to the extent that he still has in his hands money owing to the prime contractor at the time he receives notification of the lien claimant's interest. That is the position taken in Alternative A of Section 207.

However, recognizing that some states impose somewhat greater liability presently and may wish to continue to do so under a modern, uniform statute, the following section has been prepared. It may be substituted for Alternative A of Section 207 without requiring changes in other sections.

Alternative B gives subcontractors a lien against an owner, other than a protected party owner, for their full contract price provided that they notify the owner within 20 days after they first furnish goods or services. If they give notice more than 20 days after the first furnishing of goods or services, their lien claim relates back to secure the price of all goods or services furnished within 20 days of the time they did notify. Protected parties have lien liability only to the extent that money due the prime contractor has not yet been paid at the time they receive notice of the claimant's lien.

ALTERNATIVE B

[SECTION 207. AMOUNT OF CONSTRUCTION LIEN.

(a) Subject to subsection (f), the lien of a prime contractor is for the unpaid part of the prime-contract price.

(b) Except as against a protected party contracting owner and subject to subsection (f), the lien of a claimant other than a prime contractor is for the unpaid price of services and materials provided within 20 days before, or at any time after, the owner receives from the claimant a notice of lien liability (Section 205).

(c) Except as provided by subsections (d) and (e), as against a protected party contracting owner, the lien of a claimant other than a prime contractor is for the lesser of:

(1) the amount unpaid under the claimant's contract; or

(2) the amount unpaid under the prime contract through which the claimant claims at the time the contracting owner receives the claimant's notice of lien liability (Section 205).

(d) If a contracting owner is a protected party and the contracting owner's lien liability under a prime contract (subsection (e)) is less than the total amount of claims of all claimants claiming through the prime contractor:

(1) lien claimants whose liens attach at different times have liens in the order of attachment until the owner's lien liability is exhausted; and

(2) among claimants whose liens attach at the same time, each claimant's lien is for that claimant's proportional amount of the contracting owner's lien liability to those claimants.

(e) If a contracting owner is a protected party, the construction lien liability of the owner under a particular prime contract is the prime-contract price less payments thereon properly made. A payment on a prime-contract price is properly made to the extent the payment:

(1) is made in good faith before receipt by the contracting owner of a notice of lien liability (Section 205); or

(2) if made after receipt by the contracting owner of a notice of lien liability, is made in good faith and leaves unpaid a part of the prime contract price sufficient to satisfy the unpaid claims of all claimants who have given notice of lien liability and whose claims are not being satisfied by the payment.

(f) The construction lien of a claimant is reduced by the sum of the construction liens of other claimants who claim through that claimant.]

COMMENT

1. Except as against a protected-party owner, a claimant other than a prime contractor may assert a lien against the owner for the claimant's full contract price if the owner receives from the particular claimant a notice of lien liability within 20 days after the first furnishing of services or materials by the claimant under his contract. If, for example, an owner paid a prime contractor in full in advance for a particular project and the prime contractor then employed several subcontractors who were not paid, the subcontractors, if they notified the owner within the 20-day period, could assert a lien against the owner's real estate for their full contract price. In such a case the owner might find it necessary to pay substantially more than the contract price for the improvement to protect his real estate against liens. The same rule as to double liability would apply to lien claimants more remote than the subcontractor tier. If a lien claimant's notice of lien liability is received by the owner more than 20 days after the first furnishing of services or materials by the claimant, the rules described above continue to apply with the exception that the claimant's lien does not extend to the price of goods or services furnished more than 20 days prior to the time the notice is received by the owner.

2. A protected-party contracting owner has no lien liability to claimants except to the extent that he has not yet paid the contract price to the prime contractor at the time he receives notice of the claimant's right to assert a lien (Section 205). Following are some examples which indicate the operation of the rules as to protected-party owners.

Example 1. Owner has contracted with prime contractor for construction of a home at a price of \$100,000. When the owner has paid the prime \$80,000 under the contract, the owner receives notice from subcontractor A that A is owed \$10,000. Owner pays prime another \$10,000 but reserves \$10,000 to pay A. Before Owner actually pays A, he receives notice from subcontractor B that he, too, is owed \$10,000 by prime. A notice of commencement is effective as to the improvement so that A and B's liens attach at the same time. Subcontractors A and B each have a lien for \$5,000. The applicable sections are (d) and (e). Since the owner's payments were either made before notice from a lien claimant, or were made afterward but withholding enough to pay all claimants who had notified, he had properly paid \$90,000. Therefore, under (d), the lien of each claimant is for his pro rata portion of the owner's total lien liability.

Example 2. Same as Example 1, except that Owner pays \$15,000 to prime after having been notified of subcontractor A's claim. A and B still have a lien of \$5,000 each. Owner's payment to prime was not properly made to the extent that it reduced the remaining contract price due below the claim of subcontractor A.

Example 3. Same as Example 1, except that Owner, in addition to the payment to the prime contractor, pays \$5,000 to subcontractor A before receiving notice of subcontractor B's claim. Owner has, therefore, properly paid \$95,000 and has a total lien liability of only \$5,000. Subcontractor A has a lien claim of \$5,000 (one-half of his \$10,000 claim having been paid) and subcontractor B has a lien claim of \$10,000, but since this is greater than the owner's lien liability, subsection (d) comes into play, and subcontractor A receives one-third of \$5,000 (the owner's lien liability), and subcontractor B receives two-thirds.

(Note that in all of the above examples, the prime contractor has no lien because of subsection (f).)

Example 4. Owner has contracted with prime for construction of a home at a price of \$100,000. When the owner has paid the prime \$80,000 under the contract, the owner receives notice from subcontractor A that A is owed \$10,000. He then receives notice from sub-subcontractors one and two that subcontractor A owes them \$3,000 and \$2,000 respectively, a notice from subcontractor B that he is owed \$10,000, and from sub-subcontractor three, who contracted with subcontractor C (who has been paid in full) that he has a claim for \$10,000. Owner does not pay out any additional money to prime. A has a lien of \$5,000 (\$10,000 reduced by the total of the liens of those who claim through him), B has a lien for \$10,000, one has a lien for \$3,000, two for \$2,000 and three for \$10,000. Therefore, the total of the lien claims is \$30,000 but, since that is greater than the owner's total lien liability of \$20,000, each claimant's lien is reduced by one-third (each receives his pro rata part of the owner's total lien liability).

Example 5. Owner has contracted with prime for construction of a home at a price of \$100,000. When Owner has paid the prime \$90,000, Owner receives a notice of lien liability from Supplier claiming that subcontractor D has not paid a \$10,000 amount for which supplier asserts a lien. Prime has paid subcontractor D in full. Supplier has a \$10,000 lien and Owner

should pay Supplier rather than prime. Prime will have to undertake to recover \$10,000 from D and, if he is unable to do so, will suffer a loss of \$10,000.

In all of the above examples, it has been assumed that Owner will pay the amount of the construction liens to protect his real estate. If the owner does not pay, the claimants' remedy is to foreclose against the real estate. In that event, if there are prior encumbrances against the real estate, there may be no recovery for the lien claimants. If the sale produces some money for the lien claimants, but not enough to pay all claims, the money received is distributed to claimants according to the priority rules of Section 208.

3. Whether or not he is a protected party, an owner's liability to a prime contractor is reduced by the amounts the owner pays to claimants claiming through that contractor. While the statute does not explicitly state that payments made by an owner to discharge liens of claimants other than the prime contractor go toward reducing the owner's contractual liability to the prime, it does state that the lien of the prime is reduced by the sum of the liens of claimants who claim through him. The clear implication of that rule is that the owner's personal liability to the prime is also discharged. Therefore, if a prime contractor pays a subcontractor who in turn fails to pay a sub-subcontractor or materialman, the risk of that nonpayment is on the prime. Because of this risk, some prime contractors may wish to engage in policing activities to assure themselves that all participants in the project below them are paid. If a protected-party contracting owner pays the prime contractor sums which do not reduce the owner's liability to lien claimants claiming through the contractor, the owner can recover back those payments from the prime. Similarly, as between an owner who is not a protected party and the prime contractor, the risk that liens will be asserted by claimants claiming through that prime is on the prime and, if an owner has already made payments to the prime, which, together with his lien liability to claimants under that prime, exceed the contract price, the owner can recover the excess from the prime.

4. Section 209 states that, as among construction lien claimants, all liens attaching at the same time have equal priority, but that liens which attach at different times have priority among themselves in the order of attachment. Under Section 208, liens recorded while there is no effective notice of commencement covering a project take priority as of the earlier of recording or visible commencement, while liens recorded after recording of a notice of commencement take priority as of the time the notice of commencement was recorded. Therefore, in cases where a lien claimant records and subsequently a notice of commencement is recorded as to the project, that claimant will have priority over claimants who record after the notice of commencement is recorded.

The following example indicates how the rules of those sections apply in relation to the rules as to protected-party owner liability stated by this section.

Example. Protected-party owner undertakes an improvement project without recording a notice of commencement. Before a notice of commencement is recorded, but after visible commencement, subcontractor A records a notice of lien. His priority date is, therefore, time of visible commencement (Section 208). Thereafter, a notice of commencement is recorded

covering the improvement. Then subcontractor B records a notice of lien. Subcontractor B's lien has priority as of the date of recording the notice of commencement. Subcontractor B then gives Owner a notice of lien liability claiming \$10,000. Owner pays subcontractor B before subcontractor A notifies Owner that he has a \$10,000 lien claim.

Subcontractor A's lien attached first, and in that case, subcontractor B's lien is subordinate to that of subcontractor A because, under subsection (c)(i), "lien claimants whose liens attach at different times have liens in the order of attachment until the owner's lien liability is exhausted." The owner's lien liability is only \$10,000, and payment to subcontractor B has discharged that liability. Therefore, even though A recorded first, he would, in effect, lose his lien to B who collected.

If, however, before owner paid B, owner also received a notice from A that A was owed \$10,000, owner is put on notice of the claims of both A and B and would be obligated to pay them according to their priority position. If, for example, owner paid \$5,000 to each, owner would nevertheless be liable to A for the additional \$5,000 due to A because of A's priority over B.

As the last example indicates, an owner who has received notice from several lien claimants cannot always assume that they are entitled to pro rata distribution of money still due the prime. That will be true only if all who have notified have equal priority. If none of those who have notified have recorded, the owner may make pro rata distribution without any risk since, by making the payment he will have entirely discharged his lien liability, and any subsequent recording will not affect his liability. If some claimants who have notified the owner have recorded and some have not, the owner should be able to pay all claimants pro rata and discharge his liability if those claimants who have not recorded could, by recording, gain equal priority with those who have previously recorded. If those claimants who have not recorded could not gain equal priority, the owner could discharge his lien liability by paying, to the extent of his liability, those claimants with priority.

SECTION 208. ATTACHMENT OF CONSTRUCTION LIEN; RECORDING REQUIRED.

(a) A construction lien does not attach and may not be enforced unless the claimant has recorded the lien after entering into a real estate improvement contract and within 90 days after the date the claimant provided the final materials or services pursuant to the contract.

(b) If a construction lien is recorded while a notice of commencement is effective as to the improvement in connection with which the lien arises, the lien attaches as of the time the notice is recorded (Section 301), even though visible commencement occurred before the notice is recorded. A notice of commencement is not effective until recorded and, after recording, is effective until it lapses. A notice of commencement lapses at the earlier of its expiration (Section 301(b)) or the date it is terminated by a notice of termination (Section 302).

(c) If a construction lien is recorded while there is no effective notice of commencement covering the improvement in connection with which the lien arises, the lien attaches at the earlier of visible commencement of the improvement or the recording of the lien. However, if visible commencement has occurred before or within 30 days after the lapse of the last notice of commencement covering the improvement:

(1) the lien attaches at the time the lien is recorded if the lien is recorded within 30 days after lapse of the last effective notice of commencement; or

(2) the lien relates back to and attaches 31 days after the termination date if the lien is recorded more than 30 days after lapse of the last effective notice of commencement.

(d) If new construction is the principal improvement involved and the materials, excavation, preparation of an existing structure, or other preparation are readily visible on a reasonable inspection of the real estate, visible commencement occurs when:

(1) materials are delivered preparatory to construction to the real estate to which the construction lien attaches;

(2) excavation is begun on the real estate to which the construction lien attaches; or

(3) other preparation of an existing structure to receive the new construction, or other preparation of the real estate to which the construction lien attaches, is begun.

(e) In a case not covered by subsection (d), the time visible commencement occurs is to be determined by the circumstances of the case.

COMMENT

1. A claimant has no right to enforce a lien unless he records his lien no later than 90 days after his final furnishing of services or materials. Therefore, even though a claimant notifies the owner (Section 205) at such a time that the claimant has a right to assert a lien against the owner for full contract price, he nevertheless loses the lien unless he records within the 90-day time limit. No doubt, however, in many cases, the notice to the owner will result in payment of the claimant before the expiration of the recording period and there will be no need to record.

As just noted, to have a valid lien, the claimant must record within 90 days after "final furnishing of materials or services pursuant to the contract." The determination of when final furnishing of materials or services has occurred will often present some difficulty. The fact situations which arise are so diverse that the drafting committee did not attempt to provide a statutory definition of "final furnishing of materials or services pursuant to contract." In many contracts, the contractor has an obligation to perform warranty work after the job has been completed and the owner takes possession. In those cases, the progress of the job frequently shifts over fairly imperceptively from finishing up the work to warranty work which corrects defects and shortcomings in the earlier work. Warranty work may, and frequently does, occur months or years after the owner has accepted the work and taken possession of the building or other structure. Such warranty work generally should not be treated as "furnishing materials or services" which extends the time for recording the lien. Warranty work which occurs before acceptance of the work by the owner may, or may not, be work which extends the time for recording the lien, depending on the circumstances of the individual case. If the contract is one under which an architect or engineer is to certify that the contractor has completed the work and is entitled to final payment, issuance of the certificate is strong evidence that final furnishing of services and materials has occurred. In any event, courts should be suspicious of small amounts of work done after a significant break in activity (especially work done more than 90 days after the last previous work) which may be done solely to keep open or revive the period for recording a lien. Such "make-work" should not extend the time for recording.

2. "Attachment" under this Article is a priority concept. Under Section 209 liens which attach at the same time have equal priority, and under Section 210 the time of attachment is the claimant's priority date against third parties, such as judgment creditors or holders of security interests.

3. Subsection (b) provides that a claimant's lien attaches (and therefore takes priority) as of the date a notice of commencement was recorded if the notice of commencement is effective as to the improvement at the time claimant records. Therefore, in the normal case in which a notice of commencement is recorded, all claimants on the job will take priority as of the time the notice of commencement is recorded, even though some of them record before others.

4. Subsection (c) states the rule that, if no notice of commencement has been recorded at the time a lien is recorded, the lien attaches as of the earlier of visible commencement of the improvement or recordation of the lien. This rule recognizes that lien claimants cannot control the recording of a notice of commencement and reflects a conclusion that failure of the owner to record a notice of commencement shall not be allowed to delay the priority date of claimants.

5. The following example illustrates the relationship between subsection (b) and (c). Assume that visible commencement occurs on January 15 and that, at that time, no notice of commencement has been recorded. On March 15th, a notice of commencement is recorded which covers the previously commenced improvement. On April 15th, a lien is recorded. The lien attaches as of March 15th. If, however, the lien claimant had recorded a lien on March 1st, it would have attached as of January 15th, the date of visible commencement and the later recording of the notice of commencement would not affect that attachment date.

As the example shows, a claimant who contracts to work on a project as to which a notice of commencement has not been recorded runs the risk that the attachment date of his lien will be delayed by a subsequent recording of a notice of commencement. The claimant, however, may protect himself against that risk by determining whether or not a notice of commencement has been recorded or by recording his lien. If he knows that a notice of commencement has not been recorded, he may record a notice of commencement himself. (See Section 301.)

The rule allowing the priority of unrecorded liens to be controlled by the date a notice of commencement is recorded, even though the notice is recorded after visible commencement of the project, is necessary to give effect to the basic policy of permitting determination of priority between lien claimants and others by reference to a record event. If a claimant's priority dated from the time a prior notice of commencement was recorded only if the notice had been recorded prior to visible commencement, third parties would always have to make an off-the-record inquiry to determine when visible commencement occurred.

6. If a previously effective notice of commencement has lapsed, a lien cannot attach earlier than the day the lien is recorded or 31 days after the lapse of the last effective notice of commencement, whichever is earlier. This limitation on relation back to visible commencement provides persons who deal with the land a mechanism for assuring themselves that no construction lien claimant can later come in and take priority over their interest. Assume, for example, that Owner has constructed a building which he intends to lease to Lessee. A notice of commencement was filed on January 1 and construction was completed on June 1. The notice of commencement by its terms expired on July 1. On July 15th, there are no liens which were recorded either during the period January 1 to July 1, or thereafter. Lessee can be sure that, if he

records his lease on July 15th, no subsequent construction lien can take priority over his lease interest. If the visible commencement priority rule applied in all cases where there is no effective notice of commencement, Lessee (or others similarly situated) would run the risk that some claimant would later record a lien which would then take priority over his (or their) interest.

Of course the lien claim to be effective against the lessee or the owner would have to be recorded within 90 days of the final furnishing of services or materials, but that is an uncertain time and the running of that time does not provide as certain a protection for third parties as does lapse of the notice of commencement.

7. In situations in which lien priority dates from the time of visible commencement of the project, substantial uncertainty exists as to how much change or activity on the site constitutes visible commencement. Subsection (d) should reduce the uncertainty by stating that, in the case of new construction, the basic test is that the commencement be "readily visible on a reasonable inspection," and that, if that test is satisfied, delivery of materials to the site, excavation on the site, or other preparation of the site constitutes visible commencement. Subsection (d) deals only with cases in which new construction is the principal improvement. In other cases, such as repair of existing structures, subsection (e) states merely that the time of visible commencement is controlled by the circumstances of the case.

Some claimants will have liens in cases in which there was never any visible commencement, as in the case of architects who prepare plans for an improvement which is then not made. In those cases, if no notice of commencement has been recorded, the lien attaches when the lien is recorded.

SECTION 209. PRIORITY AMONG CONSTRUCTION LIEN CLAIMANTS.

(a) All construction liens attaching at the same time have equal priority and share the amount received upon foreclosure of the liens and available for distribution to construction lien claimants in the proportions the respective liens bear to the total of all liens attaching at that time.

(b) Except as provided by subsection (c), construction liens attaching at different times have priority in the order of attachment.

(c) A claimant who records a notice of commencement after recording a construction lien has only equal priority with claimants who record a lien while the notice of

commencement is effective. Any priority a claimant gains over third parties by recording the lien (Section 210) is preserved for the benefit of all claimants having equal priority under this subsection.

COMMENT

1. In determining the amount to which a claimant is entitled in a foreclosure proceeding, it is first necessary to determine the amount of lien under Section 207 and then his priority for that amount as against all other lien claimants in the foreclosure. The following two examples indicate the interrelationship between this section and Alternative A of Section 207.

Example 1. Owner contracts with prime for an improvement at a price of \$100,000. A notice of commencement is recorded. At a time when Owner has paid prime \$80,000, subcontractors A and B give the owner notices of lien liability which indicate that A is owed \$15,000 and B \$10,000 for which they have a right to assert a lien. Since the total claims exceed Owner's liability, under Section 5-206 each claimant's lien is reduced proportionally to \$12,000 and \$8,000 respectively. Owner does not pay the claims, liens are properly recorded, and a foreclosure takes place. The real estate is sold for \$90,000, but, after paying off a prior mortgage and the expenses of sale, only \$10,000 is available for distribution to lien claimants. Each claim will receive a proportionate part of the \$10,000: \$6,000 to A and \$4,000 to B.

Example 2. Owner contracts with Prime I at price of \$100,000 for a portion of the work, and with Prime II at a price of \$200,000 for the rest of the work. A notice of commencement is recorded. At a time when Owner has paid Prime I \$80,000, subcontractors A and B, who contracted with Prime I, give the owner notices of lien liability which indicate that A is owed \$15,000 and B \$10,000 for which they have a right to claim a lien. And, at a time when Prime II is owed \$40,000, subcontractor C, who contracted with Prime II, notifies Owner that he is entitled to assert a lien for \$40,000. A has a lien for \$12,000, B for \$8,000, and C for \$40,000. If the real estate is sold and produces \$30,000 for distribution to lien claimants, A will receive \$6,000, B \$4,000 and C \$20,000.

Both examples indicate the two-step process involved in determining the percentage of a claimant's debt which will be paid: first determination of the amount of lien under Section 207 and then distribution of a pro rata proportion of the sale proceeds based on the amount of lien.

Since, under Alternative B of Section 207, a nonprotected party owner's liability is not limited to amounts not yet paid by the owner, the determination of the amount which each lien claimant will receive on foreclosure is simpler. Suppose, for example, that subcontractor A notifies owner within 20 days of the time he goes on the job that he has a right to assert a lien for \$30,000. Subcontractor B fails to notify within 20 days, but does notify before he completes his job. Subcontractor B establishes that services and materials furnished within 20 days before, and after, he gave notice were four-fifths of his contract obligations and that his contract price was

\$25,000. B has lien for \$20,000. If, on foreclosure sale, the real estate produces a net of \$25,000 to be distributed to lien claimants, subcontractor A will receive \$15,000 and subcontractor B \$10,000. Under Alternative B, it will make no difference whether A and B contracted with the same, or with different, prime contractors. The protected-party owner under Alternative B of Section 207 is subject to the rules applicable under Alternative A discussed above.

2. In cases where no notice of commencement has been recorded, subsection (c) prevents a claimant from gaining priority over other claimants by recording his lien and then recording a notice of commencement. If, however, after a claimant records, a notice of commencement is recorded by the owner or by any other claimant, the claimant who recorded his lien prior to the recording of the notice of commencement does have priority over claimants who record after the notice of commencement is recorded.

SECTION 210. PRIORITY OF CONSTRUCTION LIEN AS AGAINST CLAIMS OTHER THAN CONSTRUCTION LIEN CLAIMS.

(a) Except as provided in this section, a construction lien has priority over adverse claims against the real estate as if the construction lien claimant were a purchaser for value without knowledge whose interest was of record when the construction lien attached.

(b) Except as provided in subsection (c), a construction lien has priority over subsequent advances made under a previously recorded security interest if the subsequent advances were made with knowledge that the construction lien had attached.

(c) Notwithstanding knowledge that the construction lien has attached or the advance exceeds the maximum amount stated in the recorded security agreement, and whether or not the advance is made pursuant to a commitment, a subsequent advance made under a security agreement recorded before the construction lien attached has priority over the lien if:

(1) the subsequent advance is made under a construction security agreement and is made in payment of the price of the agreed improvements;

(2) the subsequent advance is made or incurred for the reasonable protection of the security interest in the real estate, such as payment for real property taxes, hazard insurance premiums, or maintenance charges imposed under a common interest community declaration or other covenant; or

(3) the subsequent advance was applied to the payment of any lien or encumbrance that was prior to the construction lien.

(d) To the extent that a subsequent security interest is given to secure funds used to pay a debt secured by a security interest having priority over a construction lien under this section, the subsequent security interest is also prior to the construction lien.

(e) Even though notice of commencement has been recorded, a buyer who is a protected party takes free of all construction liens that are not of record at the time the title document is recorded, or, if the protected party is a lessee for one year or less, at the beginning of the lease term.

COMMENT

1. The rules as to when a lien attaches are stated in Section 208. Under that section, depending on the circumstances, a lien will attach at one of three times: (1) recording of notice of commencement, (2) visible commencement, or (3) recording of lien. If a claimant records a lien after a notice of commencement has been recorded, under the rules of this section and Section 208, he has priority over any interest which would have lost to a purchaser for value without knowledge who recorded at the time the notice of commencement was recorded. Similarly, if a claimant records after visible commencement and while no notice of commencement is effective, he has priority over any interest which would have lost to a purchaser for value without knowledge who recorded when visible commencement occurred.

2. Subsections (b) and (c) of this section govern lien claimants rights as against future advances under prior recorded security interests.

An advance made with knowledge of an attached construction lien does not take priority over the lien even though it was committed without knowledge of the attached lien or before the lien attached. On the other hand, under subsection (c), if the advance is made under a

construction security interest and is actually applied to payment of the price of the improvements, the construction advance has priority over prior attached mechanics' liens whether or not the advance was made pursuant to a prior commitment. Construction security interest is defined in Section 102 (4). The rule of subsection (c) is based on the assumption that, more often than not, it is to the interest of lien claimants as a class to have the construction lender continue to supply funds to the project, even though some claimants might gain by a rule which gives them priority over the lender.

If the holder of a construction security interest makes an advance to the owner which is diverted to some purpose other than payment of a prime contractor or some lien claimant on the job, the advance is not "made in payment of the price of the agreed improvements," and the construction lender's priority would be determined, not by subsection (c)(1), but by subsection (b).

It should be remembered that, in practically all cases, the lender will follow owner's instructions as to disbursements, and, if the owner has been notified by a lien claimant of a right to claim a lien, he will, to protect himself, ask the lender to withhold money from the prime contractor or to pay directly to a lien claimant. Therefore, while a claimant will have no direct rights or priority as against a construction lender who continues to provide funds for a project without making sure that the funds pay lien claimants, the claimant's rights upon notification to the owner will nearly always actually result in the lender taking account of the claimant's rights. In this regard, it should be remembered that, under Section 501 of this Act, the owner is trustee of construction loan funds for the benefit of lien claimants.

Under subsection (c)(2), a subsequent advance made or incurred for the reasonable protection of the security interest takes priority over an attached construction lien, whether or not the advance was made pursuant to commitment.

Subsection (c)(3) and subsection (d) give priority to subsequent security interests or to subsequent advances under prior security interests to the extent that the funds advanced are used to pay off security interests which were prior to the construction lien. This statutory subrogation of the latter to the prior interest recognizes that the lien claimant is not prejudiced by having one creditor substituted for another so long as the total amount having priority over his interest is not increased.

3. Under subsection (e), a protected-party buyer takes free of construction liens not recorded at the time he records his interest even though a notice of commencement has been recorded or visible commencement has occurred. In recent years, substantial attention has focused on the high cost of residential real estate closings. A major purpose of this Act is to create a legal environment conducive to reduction of those costs. Subsection (e), which permits closing without off-the-record inquiries, even in cases in which a notice of commencement has been recorded or visible commencement has occurred, is an important element in the achievement of that purpose. Since the protected party takes free of unrecorded lien claims, under the usual rules applicable to grantees from parties who were not subject to prior interests,

any subsequent parties who claim through the protected party also take free of the unrecorded lien. This rule is particularly important to lenders who provide financing to protected party buyers and take from the protected party a security interest on the premises. If the rule did not protect lenders who take security interests from protected parties, the rule stated in subsection (e) would provide no significant protection to protected parties who would be unable to procure financing.

SECTION 211. DURATION OF CONSTRUCTION LIEN; STATUTE OF LIMITATIONS.

(a) Except as provided in subsections (b) and (c), a construction lien that has become enforceable as provided in this [Act] continues to be enforceable for one year after recording of the lien (Section 303) or, if an amendment or continuation thereof (Section 304) has been recorded during the period allowed for recording the original construction lien (Section 209), one year after that recording.

(b) Except as provided in subsection (c), if an owner, holder of a security interest, or other person having an interest in the real estate gives the claimant written demand to commence a judicial proceeding within 30 days, the construction lien lapses unless within 30 days after receipt of the written demand, the claimant commences a judicial proceeding and records a notice of pending proceeding or records an affidavit that the total contract price is not yet due under the contract for which the lien was recorded (Section 308(b)). If the claimant commences a judicial proceeding under this subsection, the court shall afford a prompt hearing.

(c) If a judicial proceeding to enforce a construction lien is commenced while a lien is effective under subsection (a) or (b), the lien continues during the pendency of the proceeding if a notice of pending proceeding is recorded and remains effective.

COMMENT

A claimant may record or re-record his lien within 90 days after his final furnishing of materials or services and have one year thereafter to foreclose. However, any person interested in the real estate can cut that period short by giving notice of demand to institute foreclosure. In this instance, "real estate" means the land itself, so that, in cases in which the contracting owner is lessee or life tenant, the lessor or remainderman respectively could make the demand to institute suit even though his interest is not subject to the lien. (See the definition of real estate in Section 102(16).)

Since a lien may be recorded before the amount for which a lien is claimed is due, and demand to institute suit can be made at any time after a lien is recorded, demand to institute suit might be made before a cause of action exists. In such a case, the claimant defeats the effect of the recorded demand by recording a statement that not all amounts payable under the contract are yet due. (Even though some part of the contract price for which the lien is claimed might be past due and subject to an immediate suit, the claimant is not obligated to bring a suit in response to the demand unless the total contract price is due.) The last sentence of subsection (b), requiring prompt hearing, is intended to assure that lien claims are promptly disposed of to prevent lingering clouds on titles.

SECTION 212. SURETY BOND; NO CONSTRUCTION LIEN ATTACHES.

(a) A construction lien does not attach to real estate on behalf of a claimant claiming through a prime contractor if the owner or the prime contractor has procured from a surety company authorized to do business in this State a bond meeting the requirements of this section and has recorded a notice of surety bond (Section 306).

(b) The bond must obligate the surety company, to the extent of the penal sum of the bond, to pay all sums due to construction lien claimants other than the prime contractor for services and materials provided pursuant to the contract under which the lien would otherwise arise.

(c) The penal sum of the bond must be not less than:

(1) fifty percent of the contract price, if the prime contract price is not more than \$1,000,000;

(2) forty percent of the contract price, if the prime contract price is more than \$1,000,000 and not more than \$5,000,000;

(3) twenty-five percent of the contract price, if the prime contract price is more than \$5,000,000 and not more than \$25,000,000; or

(4) fifteen percent of the contract price, if the contract price is more than \$25,000,000.

(d) The person procuring the bond shall furnish to any claimant on request a true copy at cost of reproduction and is liable to the requesting claimant for any damages caused by unjustified failure to furnish a copy.

(e) A claimant may not recover under the bond unless:

(1) a judicial proceeding is commenced against the surety within one year after the completion of the claimant's performance or within any longer period permitted by the terms of the bond; and

(2) if the claimant does not have a direct contract relationship with the prime contractor, within 90 days after completion of the claimant's performance the claimant gives the prime contractor written notice of the amount due.

(f) A claimant having a claim under the bond may proceed directly against the surety. A judicial proceeding on the bond may be maintained separately from and without commencing a proceeding against the prime contractor and without complying with the procedures for notice and recording under this [Act]. In a judicial proceeding on the bond, the Court shall award to the prevailing party court costs and reasonable attorney's fees.

(g) The obligation of a surety under this section is not affected by any modification of the contract between the prime contractor and the contracting owner, but the total liability of the surety may not exceed the penal sum of the bond.

COMMENT

1. This section permits an owner to assure that no liens will be asserted against his real estate by any claimant other than the prime contractor. As to the prime contractor, no statutory method of protecting against liens is necessary because the owner and the prime may, in their contract, agree that the prime will not assert a lien. Typically, the prime contractor purchases the payment bond referred to in this section. There is no reason, however, why the statutory protection against liens should be limited to cases in which the bond is acquired by the contractor.

2. The parties, if they choose, may provide bond amounts larger than those required by the Act to encourage a greater number of, and lower, bids by subcontractors and materialmen on large projects.

3. Procuring the bond does not prevent liens from attaching unless a notice of surety bond is recorded. If the surety bond is procured and notice recorded, claimants have a direct cause of action against the surety company and do not have to comply with the provisions of this Act requiring notice to the owner or recording of a lien. Also, if a notice of bond is recorded, it is not necessary to record a notice of commencement.

4. Subsection (g) negates the common law rule that any change of the contract terms between the principal and the creditor discharges the surety.

5. The bond under this section must relate to particular prime contractors and their contract price. Under this Act, in cases in which the owner contracts directly with a number of furnishers of services and materials, each is a prime contractor whose name and contract price must appear in the bond. There is, however, no reason why a single bond naming a number of different prime contractors could not be written. However, in such a case, it is the amount of each individual prime contract, rather than the aggregate amount, which determines the required bond amount.

6. There is no provision in this Act for the use of sureties other than professional surety companies. Therefore, sureties such as "good and solvent freeholders of the county, etc. ..." may not be used. However, liens which have already attached may be shifted to a deposit of money as substitute collateral under Section 213.

7. The Act does not set out a statutory form of bond. Therefore, the issuing surety may use its standard form of bond so long as the bond does not impose unreasonable restrictions on

the ability of a claimant to recover and so long as the bond does not attempt to vary the specific provisions of this section. Surety bonds often include a provision requiring some advance notice to the surety before suit is filed to recover on the bond. Such provisions, if reasonable, are effective under this section. For example, a bond could properly contain provisions for notice prior to suit similar to the following:

No action may be brought on this bond unless the claimant gives notice to the surety in writing of its claim more than 30 days prior to the commencement of the action. The notice must contain: (1) the name of the claimant and an address to which the surety may send communications to the claimant; (2) the name and address of the person with whom the claimant contracted; (3) the bond number or other information sufficient to allow the surety to identify the bond and the name of the principal under the bond on which the claim is being made; (4) a general description of the services or materials provided or to be provided; and (5) the amount unpaid to the claimant for services or materials, whether or not due, and if no amount is fixed by the contract, a good faith estimate of the amount, designated as an estimate.

8. Under the Act, the court is directed to award attorney's fees to the prevailing party. Cases will arise in which the surety admits liability for a specific dollar amount less than that claimed by the claimant and prior to trial tenders payment of the amount admitted. In such a case, if the claimant does not accept the tender and the ultimate amount awarded by the court is not more than the amount originally admitted by the surety to be due, the surety is the prevailing party and is entitled to recover its attorney's fees. Section 403 of this Act allows recovery of damages, including attorney's fees, against a claimant who in bad faith inflates a claim. Under the present section, however, a surety against whom a judgment is entered for no more than the amount the surety originally admitted to be due and tendered is the prevailing party and entitled to an award of attorney's fees even though the claimant asserted the higher claim in good faith. In states which have generally applicable offer of judgment provisions (see, *e.g.*, Rule 68 of the Federal Rules of Civil Procedure) it is appropriate to apply those rules to the tender of the amount admitted to be due.

9. Under this section, action on the bond must be brought within one year after "completion of the claimant's performance" unless the bond permits a longer time. Also, if the claimant did not contract with the prime contractor, the claimant must give notice to the prime within 90 days after "completion of the claimant's performance." "Completion of the claimant's performance" is not defined in the Act. Section 208 which specifies the time within which liens must be recorded to be effective uses somewhat different terminology. It requires recording within 90 days after "final furnishing of services or materials pursuant to the contract." The difference in language between this section and Section 208 is not intended to fix a beginning point for fixing the time within which suit must be brought or notice given to a prime contractor different from that for recording against the owner under Section 208. Therefore, "completion" in this section should be interpreted in the same way as "final furnishing of materials or services" under Section 208. See Comment 1 to Section 208.

SECTION 213. SUBSTITUTION OF COLLATERAL; RELEASE OF LIEN.

(a) A person having an interest in real estate may release the real estate from construction liens that have attached to it by:

(1) depositing in the office of the [clerk of court] a sum of money, in cash, certified check, or other bank obligation, or a surety bond issued by a surety company authorized to do business in this State, in an amount sufficient to pay the total of the amounts claimed in the liens being released; and

(2) recording, as provided in Section 307, a certificate of the [clerk] showing that the deposit has been made.

(b) The [clerk of court] shall accept the deposit and issue the certificate.

(c) Upon release of the real estate from a construction lien under this section, the claimant's rights are transferred from the real estate to the deposit or surety bond, and upon determination of the claim the court shall order the [clerk] to pay the sums due or render judgment against the surety company on the bond, as appropriate.

COMMENT

This section provides a way by which any person with an interest in the real estate may free the real estate itself from the lien by shifting the lien to a cash or bond substitute. The shifting of the lien from the real estate does not otherwise in any way affect the rights of the claimant or others. If, for example, it can be subsequently established, as a result of foreclosure or otherwise, that because of prior third party rights, there is no interest in the real estate which can be reached by the lien claimants, they have no rights in the deposit. Similarly, the provisions of this Article as to the time within which suit must be brought by a claimant apply even though a deposit has been made.

SECTION 214. OBLIGATION OF CLAIMANT TO FURNISH INFORMATION TO OTHER CONSTRUCTION LIEN CLAIMANTS.

(a) A prime contractor, on request, is obligated to furnish accurate information within a reasonable time, not exceeding ten days, to any person entitled to claim a construction lien through the prime contractor, as follows:

(1) a description of the real estate being improved or benefitted sufficient to identify it;

(2) the name and address of the contracting owner with whom the prime contractor contracted; and

(3) whether there is a surety bond and, if so, the name of the surety.

(b) At the request of a person who may claim a construction lien through a contractor who is not a prime contractor, the contractor shall furnish to the claimant, within a reasonable time not exceeding five days, the name of the person to whom the contractor is obligated to provide the materials or services in connection with which the lien claim may arise.

(c) A person who fails to furnish information as required by this section is liable to the requesting party for actual damages or \$200, whichever is greater.

COMMENT

In order to assert their lien rights, claimants other than the prime contractor must know who the owner is and have a description of the real estate. This section provides them a mechanism for acquiring that information. Contracting parties other than the prime contractor are required to furnish only the name of the person with whom they contracted. Ordinarily that information will not be sought since remote claimants need only know the name of the prime contractor in order to acquire the necessary information. However, occasionally it may not be clear which prime contract is being performed by the particular work and, in that case, it may be necessary to trace the contracting chain back to a particular prime contractor. Also, occasionally a prime contractor may decline to furnish information to a remote claimant until he is satisfied that the contracting chain reaches that claimant and, in such a case, the claimant may have to make inquiries of others in the chain.

ALTERNATIVE A

[SECTION 215. WAIVER OF CLAIMANT'S RIGHTS.

(a) A written waiver of construction lien rights signed by a claimant requires no consideration and is enforceable, whether signed before or after the materials or services were contracted for or provided. Ambiguities in a written waiver are construed against the claimant.

(b) A written waiver waives all construction lien rights of the claimant as to the improvement to which the waiver relates unless the waiver is specifically limited to a particular lien right or a particular portion of the services or materials provided.

(c) A waiver of construction lien rights does not affect contract rights of the claimant otherwise existing.

(d) Acceptance of a promissory note or other evidence of debt is not a waiver of construction lien rights unless the instrument evidencing the debt expressly so provides.]

COMMENT

1. The giving of lien waivers by subcontractors and materialmen has been a pervasive part of construction industry practice and is likely to continue to be so under this Act. The execution of a written waiver practically always is the knowing act of the claimant, is generally given to facilitate the financing of the project, and is relied upon by the construction lender, owner, and others, in dealing with the prime contractor. Therefore, under this Act, a written waiver is binding without consideration. The idea of an agreement binding without consideration is not new to the law. The Wisconsin construction Lien Law, adopted in 1968, makes written lien waivers binding without consideration. Wis. Stat. 289.05 (1973). Also, the Uniform Commercial Code (Section 2-209) and the Uniform Land Transactions Act (Section 1-310) make modifications of contracts for the sale of goods or real estate, respectively, binding without consideration.

2. This Act, also following the Wisconsin Act, directs that ambiguities in a written waiver be construed against the lien claimant. Construing ambiguities against the claimant, even though he did not draft the waiver, is justified by the fact that a number of third parties, the owner, the prime contractor, the lender, or subsequent buyers or mortgagees will rely on the waiver. Subsection (b) states a rule as to a particular kind of ambiguity. In the absence of (b), it would be possible to argue, for example, that an unrestricted waiver applies only to services or materials already furnished. Subsection (b) also follows the Wisconsin Act.

3. A written waiver by a claimant is effective only as to the construction lien rights of that claimant, and does not affect the rights of other construction lien claimants whether or not they may claim through or under the claimant who has waived.

ALTERNATIVE B

[SECTION 215. WAIVER OF CLAIMANT'S RIGHTS.

A construction lien under this [Act] may not be waived before services are performed or materials are furnished, and any provision for an advance waiver is not enforceable.]

COMMENT

In some states there is an established public policy against advance waivers of construction liens. This alternative is added to make the Act adaptable to use in those states.

ARTICLE 3

RECORDING

SECTION 301. NOTICE OF COMMENCEMENT; RECORDING.

(a) Except as provided in subsection (e), a notice of commencement must be signed by the contracting owner, be denominated "notice of commencement," and state:

(1) the real estate being or intended to be improved or directly benefitted, with a description of the real estate sufficient to identify it;

(2) the name and address and interest in the real estate of the contracting owner, and the name and address of the fee simple titleholder, if other than the contracting owner; and

(3) that if, after the notice of commencement is recorded, a construction lien is recorded as to an improvement covered by the notice of commencement, the lien has priority from the time the notice of commencement is recorded.

(b) A notice of commencement may state a duration of any period, but, if the duration stated is less than six months after the recording, the duration of the notice is six months. If no duration is stated, the duration of the notice is three years after the recording, but if the notice affects residential real estate, the duration of the notice as to a protected party is one year after the recording.

(c) The notice of commencement may state that it is limited to a particular improvement, or portion thereof, on the real estate. However, the limitation is not effective unless the particular improvement, or portion thereof, to which it applies is stated with sufficient specificity that a claimant, by reasonable inquiry, can determine whether the improvement is covered by the notice of commencement.

(d) A contracting owner may extend the duration of a notice of commencement by signing and recording before it lapses a continuation statement that refers to the location in the record and date of recording of the notice of commencement and states the date to which duration of the notice is extended.

(e) In the absence of a notice of commencement applicable to an improvement, a claimant who is entitled to record a construction lien may sign and record a notice of commencement denominated "notice of commencement, claimant recording" stating:

(1) in accordance with subsection (j), the real estate being or intended to be improved or directly benefitted, with a description of the real estate sufficient to identify it;

(2) the name and address of the contracting owner against whom the notice of commencement is effective;

(3) the name and address of the claimant recording the notice of commencement;

(4) the name and address of the person with whom the claimant contracted with respect to the improvement;

(5) a brief description of the services or materials provided, or to be provided, by the claimant for the improvement; and

(6) that if, after the notice of commencement is recorded, a construction lien is recorded as to an improvement covered by the notice, the lien has priority from the time the notice is recorded.

(f) A claimant recording a notice of commencement shall send a copy of it to the contracting owner no later than the day it is recorded. The claimant is liable to the contracting owner for any damages caused by failure to comply with this subsection.

(g) This [Act] applies equally to all notices of commencement, but as to a notice of commencement recorded by a claimant:

(1) notwithstanding any stated duration, the duration is one year after the recording; and

(2) a limitation under subsection (c) is not effective.

(h) Unless a notice of commencement is limited to a particular improvement contract or project, or portion thereof, it covers all improvements made on the real estate

described in the notice whether or not they were contemplated by the person recording the notice at the time of recording.

(i) Unless a notice of commencement provides otherwise, it covers improvements made on real estate not owned by the contracting owner if, under Section 203(c), a construction lien arises against the contracting owner's real estate described in the notice of commencement as a result of the improvements.

(j) A notice of commencement recorded by a claimant (subsection (e)) may describe all or any part of the contracting owner's real estate being improved or directly benefitted.

COMMENT

1. If a recorded notice of commencement is effective as to a particular improvement at the time a lien claimant records his lien, his priority against third parties is determined by the date the notice of commencement was recorded. On the other hand, if there is no effective notice of commencement at the time he records, his priority as against third parties dates from the time of visible commencement of the improvement or the time he records, whichever is earlier.

It is frequently very difficult to determine whether visible commencement has occurred and, in any event, making the determination requires a physical examination of the site. Moreover, even after a physical inspection of the site has shown that no construction work has been "visibly commenced," the third party who is to rely on that fact may find that a lien claimant later contends that visible commencement had, in fact, occurred at the critical date. In that case, it may be difficult to produce evidence that visible commencement had not occurred or to rebut any contrary evidence offered by the lien claimant. The certainty and ease with which relative priorities can be established if a notice of commencement covering the improvement has been recorded make it highly desirable, from the point of view of third parties who deal with the real estate, that the notice be recorded.

In cases in which a construction lender, lessee, or other third party is taking an interest in real estate on which the owner is about to commence construction, the third party, if he is well advised, will insist that the transaction be structured so that the third party's interest is recorded and then a notice of commencement recorded. In that way, the construction lender or other third party can assure himself that he has priority over construction lien claimants on the project. (See Section 210(b) and (c) as to priority of subsequent advances under security interests recorded before a notice of commencement is recorded.) In the ordinary case, the construction lender will

no doubt insist that a notice of commencement be recorded before the project is commenced. If, however, some work has already been done before the construction lender comes into the picture, he may, nevertheless, assure himself of priority over lien claimants by recording his security interest and then having the owner record a notice of commencement. He will, then, have priority over all lien claimants on the project except those who recorded prior to the time the notice of commencement was recorded. (See Sections 208 and 209.)

2. While, as against the contracting owner, the amount of a claimant's lien is not affected by the time the notice of commencement is recorded (see Section 207), there are advantages to the owner in recording a notice of commencement. If the owner does not record the notice, any construction lien which attaches as a result of an improvement will attach to the real estate "being improved or directly benefitted." (Section 203(b).) Under that test, if the improvement is being made on a portion of a tract, it will not be clear how much of the tract is being improved or directly benefitted and a lien claimant may be able to argue persuasively that the entire tract is subject to his lien claim. On the other hand, if a notice of commencement has been recorded which covers the improvement, the lien is on the real estate described in the notice of commencement. (Section 203(a).)

Although, under subsection (a) (1) of this section, the notice of commencement must state the real estate intended to be improved or directly benefitted, there is no requirement that the owner include within the described land all the real estate that might later be determined to have actually been directly benefitted by the improvement. The only limitation on the owner's ability to constrict the extent of the real estate to which claimant's lien will attach is that the real estate described must include all the real estate on which improvements are actually being made. Therefore, the owner, by recording the notice, can control the real estate subject to liens.

If the owner does not record a notice of commencement, any lien claimant may record the notice and, in that recording, the claimant has the power, otherwise given to the owner, to choose the real estate to which the lien will attach. Therefore, the owner who does not record a notice of commencement runs the risk not only that a court will find that all his tract was directly benefitted by an improvement on a portion, but that a lien claimant will record a notice of commencement which claims the entire tract. While a claimant may be in bad faith if he records a notice of commencement claiming an unreasonably large portion of the owner's real estate, that bad faith will affect only his own rights, and other claimants will be able to rely on the Section 203 provision that, if the improvement is covered by a recorded notice of commencement, the lien is on the real estate described in the notice.

3. Also, the owner has power to affect the priority of various claimants through the use of the notice of commencement. In a subdivision development, for example, a separate notice of commencement might be recorded for each lot, for each block, or for any other portion of the development. Similarly, separate notices of commencement could be recorded for various elements of the improvement. For example, in case of the construction of an office building, one notice of commencement might cover the construction of the building shell and another the installation of interior walls, floor surfaces, and so on. Frequently, such stages of construction

are viewed as discrete elements in the construction process, and, if the parties choose to provide the shell construction claimants a priority over the interior wall claimants, that could be done by appropriate limitation of the improvements to which each notice of commencement applies. The above illustrations do not by any means exhaust, but merely suggest, the flexibility which the notice of commencement device gives. The only limitation on the power to restrict the notice of commencement to a part of an improvement project is the requirement that the particular improvement to which the notice of commencement is applicable be stated with "sufficient specificity that a claimant can, by reasonable inquiry, determine whether his contract is covered by the notice of commencement."

Probably most notices of commencement will be drafted so that they cover all of and only the particular improvement which the owner has in mind when the notice is recorded. However, the owner, if he chooses, may record a notice which does not refer to any particular improvement. In that case, the notice of commencement fixes the priority date for all liens recorded during the life of the notice of commencement even though they arise out of different improvement projects. But, the fact that liens to be effective, must be recorded within 90 days of the final furnishing of goods or services under the contract involved (Section 208) and that suit must be brought within one year of the recording of the lien (Section 211) limits the period of time during which liens arising out of different projects can have equal priority.

4. A notice of commencement may state its duration except that the duration may not be less than six months. If no duration is stated, the notice is effective for one year from the date it is recorded as against protected parties and for three years as against others. Since a lien claimant has 90 days after his final furnishing of materials or services to record, it seems appropriate to require that any recorded notice of commencement remain alive at least for a period of time which allows the claimant to perform and then record his lien. The six-month minimum period will protect that right of claimants in small, short-term jobs. On larger jobs, the claimant will have to determine the expiration date of any applicable notice of commencement.

It is intended that any stated duration be to a specific date which may be determined from an examination of the notice alone, as, for example, "to June 1, 1980," or, for a "period of two years after" the date of recording. A notice of commencement which states that it is effective until the building being constructed by XYZ Construction Company is complete should be treated as not stating a duration.

A notice of commencement may be terminated prior to its expiration date as to all or a part of the real estate by recording a notice of termination (Section 302). Similarly, a notice of commencement may be extended by recording, before its lapse, a continuation statement. Extension of the period of effectiveness of the notice will no doubt ordinarily occur only if the particular improvement contemplated at the time the notice was recorded is taking longer than anticipated so that, unless it is extended, some claimants who were relying upon the notice of commencement will not be protected by it. If, in other situations, an owner records a continuation statement which enables a claimant who would not have been protected by the

original notice to take equal priority with one who would have been protected, he may be liable, under Section 401, to the claimant whose priority is diluted.

As already noted, if no notice of commencement covers the improvement for which a claimant is entitled to assert a lien, the claimant may record a notice of commencement. The notice, which must be designated as a claimant recording, must describe the real estate, name the contracting owner against whom the notice is effective, and contain information (subsection (e)(3), (4), and (5)) which indicates that the claimant is entitled to record the notice. Subsection (j) makes it clear that a claimant notice of commencement may describe all or any part of the owner's real estate being improved or directly benefitted. A claimant recording need not indicate the ownership interest which the contracting owner has, nor name the fee simple owner if the owner against whom the recording is made is not the fee simple owner. Both those requirements are omitted as to a claimant recording because of the difficulty frequently involved in determining ownership status. Any duration stated in a claimant notice of commencement is not effective. Similarly, any attempt by a claimant to limit the improvements to which the notice applies is ineffective. Those limitations are intended to prevent the claimant from so restricting the notice of commencement that it applies only to his particular contract.

SECTION 302. TERMINATION OF NOTICE OF COMMENCEMENT.

(a) A contracting owner may terminate a notice of commencement as to all or any identified portion of the real estate subject to the notice of commencement by:

(1) recording a notice of termination denominated "termination of notice of commencement" and containing:

(i) the information required by Section 301(a)(1) and (2) for a notice of commencement;

(ii) a reference to the recorded notice of commencement by its location in the record and a statement of its date of recording;

(iii) a statement of the date as of which the notice of commencement is terminated, which may not be earlier than 30 days after the notice of termination is recorded; and

(iv) if the notice of termination is intended to apply only to a portion of the real estate subject to the notice of commencement, a statement of that fact and a description of the portion of the real estate to which the notice of termination applies;

(2) sending, at least 21 days before the effective date of the notice of termination, a copy of the notice of termination, showing the date it was recorded, to all claimants who have requested (Section 205(b)) that the owner notify them of the recording of a notice of termination;

(3) publishing a notice of the recording of the notice of termination, which notice must comply with subsection (b) and be published at least once a week for three consecutive weeks in a newspaper having general circulation in the county where the recording occurs, the last publication of which must be at least five days before the stated termination date; and

(4) recording an affidavit stating that the notice of the recorded notice of termination has been sent to all claimants who have requested notice and that publication has been made, stating the name of the newspaper and dates of publication and accompanied by a copy of the published notice.

(b) The published notice of the recording of the notice of termination must contain the information required for a notice of termination under subsection (a), a statement of the date on which the notice of termination was recorded, and a statement that all construction lien claims for which a notice of lien is not recorded by the termination date may be defeated by a transfer of the real estate.

(c) A purchaser, judgment creditor, or other person having any lien against the real estate may rely on an affidavit complying with subsection (a)(4) without a duty to inquire as to its accuracy, and is not prejudiced by its inaccuracy.

COMMENT

1. Frequently, at the time a notice of commencement is recorded, the completion date of the improvement project for which the notice is recorded will be uncertain and the stated expiration date of the notice of commencement will not coincide with the completion of the project. Since lien claimants, while a notice of commencement is effective, may take priority as of its recording date, title could be clouded for substantial periods beyond the time a claimant would be entitled to assert a lien, unless there were a mechanism for terminating a notice of commencement in cases where its duration is longer than the period of construction.

2. Since lien claimants may have relied upon the continuing effectiveness of the notice of commencement, termination requires a fairly elaborate procedure intended to provide (1) the best practicable warning to lien claimants that the notice of commencement is being terminated and (2) a period of time before termination within which claimants may record their liens.

The requirements for termination are: (1) The notice of termination must be recorded at least 30 days before the date specified therein as the termination date, (2) all claimants who have requested that they be furnished copies of any notice of termination must be sent a copy at least three weeks before the termination date stated in the notice, (3) the notice of termination must be published in a newspaper, as provided by subsection (a)(3), and (4) the owner must record an affidavit that publication was made and claimants notified. Since the published notice must state the date the notice of termination was recorded, and the affidavit must contain a copy of the newspaper notice and state the dates it was published, the affidavit will always be recorded at least several weeks after the notice of termination was recorded.

3. Under subsection (c), third parties may rely on an affidavit recorded by the owner asserting that he has complied with the requirements of this section and the third party takes free of any rights of lien claimants based upon improper termination or failure to comply with the requirements.

4. A notice of termination recorded at any time is effective, but, under Section 402 an owner who terminates a notice of commencement prior to substantial completion or abandonment of all improvements covered by the notice of commencement becomes personally liable to lien claimants to the extent that owner's action prevents claimants from realizing on their lien. If, for example, an owner records a notice of termination at a time when the work for which the notice of commencement had been recorded (and which it describes) is only 50% completed, the notice of termination is fully effective. After a notice of termination has become effective, no lien can attach earlier than the day it is actually recorded, or 31 days after the date the termination

was effective, whichever is earlier. (Section 208). Therefore, if, in the 50% completion case, a notice of termination becomes effective on, say, June 1, a security interest is then recorded on June 10, and a lien claimant records on June 15, the security interest has priority over the lien claimant. But, to the extent that the subsequent lien claimant could have realized on his lien had the rights of the secured party not intervened, the owner is personally liable to the lien claimant.

5. In a case in which a prospective lender or buyer discovers that an improvement has been made on property without recording a notice of commencement, he may use the notice of commencement-notice of termination device to protect himself against the possibility that some lien claimant may later record and then successfully contend that his final furnishing of materials or services was within 90 days of his recording. If lender or buyer has the owner record a notice of commencement, and, immediately thereafter record a notice of termination effective 30 days later, any lien not recorded before the termination date cannot get priority earlier than the earliest of the time the lien is recorded or 31 days after the termination date. Therefore, the lender or buyer can deal with the property during the 31 days after the termination date free of any possible claims based on liens not recorded at the time his interest was recorded.

6. The publication and dual recording requirements will make using termination statements reasonably expensive. There will, no doubt, be many cases in which a buyer or taker of a security interest of, or in, real estate, as to which an effective notice of commencement is still outstanding, will take the risk that there are no claimants who could assert a valid lien rather than have the owner go to the expense (and delay) of using the notice of termination procedure. A third party who decides to deal with real estate as to which there is an open notice of commencement is in the same position that he would be in under a visible commencement priority rule, except that he has been alerted to the risk by discovery of the notice in his title search.

SECTION 303. RECORDING CONSTRUCTION LIEN.

(a) A claimant may record a construction lien, which must be signed by the claimant and state:

(1) the real estate subject to the lien, with a description of the real estate sufficient to identify it;

(2) the name of the person against whose interest in the real estate a lien is claimed;

(3) the name and address of the claimant;

- (4) the name and address of the person with whom the claimant contracted;
- (5) a general description and the contract price of the services performed or to be performed or materials furnished or to be furnished for the improvement;
- (6) the amount unpaid, whether or not due, to the claimant for services or materials, or, if no amount is fixed by the contract, a good faith estimate of the amount designated as an estimate;
- (7) the time the last services or materials were provided or, if that time has not yet occurred, an estimate of the time; and
- (8) that, at least five business days before recording the lien, the claimant delivered to the contracting owner either the notice described in Section 205(a) or a copy of the lien to be recorded.

(b) The name stated in the construction lien in accordance with the requirement of subsection (a)(2) may be the name of the contracting owner or the name of the record holder of the contracting owner's interest at the time of recording the lien.

COMMENT

1. In this Act, the word "lien" is used to denote both the substantive right given the claimant and the instrument which he must record to secure that right. Consideration was given to possible use of the term "notice of lien" to denote the instrument but the use of the shorter "lien" to describe the instrument does not cause confusion. This section states the requirements for the instrument which the claimant must record.

2. The real estate description need not be sufficient to establish the boundaries of the real estate involved. For example, "Building at 1032 Main Street, Baytown" should be sufficient if there is only one building at that address. If a notice of commencement has been recorded, the description in the notice of commencement will frequently be used and it could be incorporated into the lien by reference. However, even though a notice of commencement has been recorded, there is no necessity that the recorded lien use the description used in the notice. Since the

claimant may not know whether a notice of commencement has been recorded, and even if he does know that one has been recorded, may not have the description contained therein, the claimant may use any description he chooses so long as it is of the "contracting owner's real estate being improved or directly benefitted."

The description in the recorded lien, whether or not a notice of commencement has previously been recorded, must be sufficient to give notice to an examiner of the record that the particular real estate of the contracting owner is subject to a lien. If the description is not sufficient to give that notice, the lien recording is not effective.

The real estate description in the recorded lien, however, is not controlling as to the real estate subject to a lien. If a notice of commencement has been recorded which covers the improvement, the lien is on the real estate described in the notice of commencement. If a notice of commencement has not been recorded, the lien is on the contracting owner's real estate being improved or directly benefitted. In either case, the real estate subject to a lien may be more or less than that actually described in the recorded lien.

Even though the description in the recorded lien is not controlling as to the real estate against which a lien arises, a claimant may be estopped from claiming real estate not described in his recorded lien. If, for example, in a case in which a notice of commencement has not been recorded, the claimant records a lien in which the real estate is described as "building at 1032 Main Street, Baytown," he may be estopped, as against a third party who relied on the restrictive claim, to assert that the entire 40-acre tract on which the building was located is directly benefitted by the work and that, therefore, the claimant has a lien on the entire tract.

If a claimant knowingly records against real estate which is not involved in the improvement project, it is likely that he will be held to have recorded his lien in bad faith, in which case, under Section 403, he loses his lien and is liable in damages.

3. The claimant must state the name of the owner against whom the lien is claimed. Since the purpose of the recording is to put third parties on notice of the existence of the lien claim, the recording is not effective against third parties dealing with a particular owner's interest unless a record search under that owner's name would reveal the recorded lien. Also, even as against the owner himself, a recording under an incorrect owner's name would not be effective unless the owner is estopped to assert the incorrect name. (See, in this regard, Section 205(c) and (d).) However, subsection (b) permits the claimant to name as the person against whom the lien is asserted either the contracting owner or the person to whom the contracting owner's interest has been transferred of record at the time the lien is recorded.

4. The claimant need include only a general description of the services or materials for which a lien is claimed. The reason for requiring a description of services or materials is to give the owner or third parties a beginning point for making inquiries of the person with whom the claimant contracted and others concerned in the project to determine whether the claim is valid. For that purpose, it is not necessary that the contract description of the work or anything like it be

set out. For example, a description such as "heating and air conditioning contract" should be sufficient. The claimant is required to state the contract price. If the price is fixed in money, the amount should be stated. The claimant must, however, in any event state in money the amount unpaid under the contract. The amount unpaid is crucial in that, as against the owner and third parties who rely on the amount stated, the claimant will not be able to assert a larger claim. Of course, since the lien may be recorded as soon as the contract is made, the actual amount ultimately unpaid and for which the claimant brings an action to foreclose will frequently be less than the amount stated in the recorded lien.

5. Since the lien is not effective unless recorded within 90 days after the claimant's final furnishing of services or materials, the recorded lien must indicate the relationship of the recording date to the date of final furnishing.

6. The requirement that the recorded lien state that the claimant gave the owner five day advance warning of the filing of course imposes that substantive requirement on the claimant. Even though such advance notice is probably not a constitutional requirement in any state, it is fair to the owner that he have advance notice of an intention to make a recording which will cloud his title. During the five day period the owner may negotiate with the claimant or take any other steps the owner believes justified.

SECTION 304. AMENDMENT OR CONTINUATION OF CONSTRUCTION LIEN.

(a) During the period allowed for recording the original construction lien, a recorded construction lien may be amended or continued by an additional recording. The amendment or continuation extends the period of enforceability of a recorded lien pursuant to the provisions on duration of lien (Section 211). An amendment adding real estate or increasing the amount of lien claimed is effective as to the additional real estate or increased amount only from the time the amendment is recorded.

(b) Even though the period allowed for recording the original construction lien has expired, a recorded construction lien may be amended for the purpose of:

- (1) reducing the amount of the lien;
- (2) limiting the real estate against which the lien is claimed; or

(3) making an apportionment of the lien among lots of a platted subdivision of record (Section 203(e)).

(c) An amendment or continuation must state the location in the record and date of recording of the notice of construction lien being amended or continued and the respects in which it is being amended or that the recording is for the purpose of continuing the period of enforceability of the lien.

COMMENT

1. A claimant may record his lien as soon as he enters into the contract under which the lien arises. Until a claimant records, there is a possibility that later conduct by the owner (such as recording a notice of termination) will affect the claimant's priority. Therefore, claimants may choose to exercise their right to record immediately.

Once a lien is recorded, the act provides an automatic method for clearing the record of stale lien claims by providing that a recorded lien lapses if suit is not brought to foreclose it within one year after it is recorded. Under that rule, if some procedure were not provided for extending the life of a recorded lien by an additional recording, liens recorded prior to completion of the job might lapse before the amounts for which the lien is asserted become due. This section, therefore, permits continuation of a lien by an additional recording so long as the additional recording comes within the time within an original recording would have been effective (i.e., 90 days after final furnishing of materials or services).

2. The additional recording can also be used to claim additional real estate or to increase the amount for which a lien is claimed. However, the amendment is effective as to additional real estate or increased amounts only from the time it is recorded and if, prior to recording, some intervening purchaser for value has recorded an interest which he took in reliance upon the original recording, the amendment would not be effective as against the third party.

It should be remembered that, if a notice of commencement has been recorded, it is the real estate description in the notice which controls as to the real estate subject to liens, so long as that description does, in fact, include all the real estate on which improvements are being made. Therefore, in cases in which a notice of commencement has been recorded, the real estate description in the recorded lien is not critical so long as the description is sufficient to give notice to third parties.

If there is no notice of commencement covering the improvement, the lien is on the contracting owner's real estate being improved or directly benefitted. However, if the claimant's recorded lien has described real estate which is less than the real estate being improved or

benefitted, the lien claimant may be precluded from asserting that his lien reaches real estate not described in his lien. In such a case, the claimant may record an amendment to include additional real estate.

In a case in which the claimant records before completion of his performance, the contract price will frequently change as a result of contract modifications. If the contract price increases, the claimant may wish to record an amendment increasing the amount for which a lien is claimed since, unless he does so, he will be unable to assert a lien for a larger sum against persons who have relied on the amount stated in the record. If the contract price is reduced, or if subsequent payments reduce the amount for which a lien will be claimed, the claimant has no obligation to record an amendment showing the reduced amount of his lien. Such a requirement would lead to an unnecessary series of recordings, but, if the claimant wishes to record an amendment reducing the amount for which a lien is claimed, he may do so.

Even after the time for recording an effective lien has expired, the claimant may effectively record an amendment to reduce the real estate against which a lien is claimed, or to apportion his lien among lots of a platted subdivision (if, under Section 203 he is entitled to make such an apportionment).

SECTION 305. RECORDING ASSIGNMENT OF CONSTRUCTION LIEN.

(a) A recorded construction lien may be assigned by its holder. The assignment may be recorded. It must be signed by the assignor and state the name of the claimant, the name and address of the assignee, the person against whom the lien is claimed, the real estate affected with a description sufficient to identify it, and the location in the record and date of recording of the notice of lien.

(b) Even though an assignment has been recorded, an owner may continue to deal with the original claimant as to the claim until the owner receives notice of the assignment and a direction that no arrangements or payments may be made without the assignee's consent. If requested by the owner, the assignee shall furnish reasonable proof that an assignment has been made and, unless the assignee does so, the owner may pay the assignor.

(c) Unless a statement of assignment is recorded, the assignee need not be a party to any judicial proceeding to foreclose a security interest, construction lien, or other encumbrance.

(d) Failure to record an assignment does not affect its enforceability.

COMMENT

1. This section specifies the required contents of a recorded assignment of a claimant's rights under a recorded lien. As between the assignor and assignee the assignment is, of course, good without recording. However, if an assignee does not record his assignment, he may lose to a subsequent assignee who does record.

2. Once an assignment has been recorded, the assignee becomes the claimant and has all the powers and rights of a claimant, such as the power to amend the recorded lien, record a continuation thereof, or record, if other circumstances permit, a notice of commencement.

3. Recordation of the assignment does not put the contracting owner on notice of its existence and he may continue to deal with the assignor until he receives notification of the assignment and a direction that no arrangements or payments be made without the assignee's consent.

SECTION 306. RECORDING NOTICE OF SURETY BOND.

(a) If a prime contractor or owner has secured a surety bond (Section 212), a notice of surety bond may be recorded.

(b) The notice must be signed by the contractor or owner and by the surety company and state:

(1) the real estate being improved with a description sufficient to identify it;

(2) the names and respective addresses of the owner and the prime contractor;

(3) the names and respective addresses of the surety company and a person on whom service of process may be made;

(4) the total sum of the bond and that the bond meets the requirements of Section 212; and

(5) that the bond is for the purpose of relieving the real estate from construction liens arising under the contract between the named prime contractor and contracting owner.

COMMENT

A surety bond under Section 212 does not protect against liens unless the recording permitted by this section is made. A prime contractor is any person who has contracted with the owner; therefore, there will be cases in which there is more than one prime contractor on an improvement project. In that case, if liens on the entire project are to be bonded, each prime contractor and the amount of his contract must be stated. That might be done either in a single recording referring to all prime contractors, or in a series of separate recordings.

Under Section 212, a surety bond, even if notice thereof is recorded, does not protect the premises against a construction lien unless the bond is issued by a surety company authorized to do business in this state and unless the bond meets the penal sum requirements of that section. Therefore, a third party who relies on the recorded notice of bond takes the risk that the issuing surety company was not authorized to do business or that the penal sums are not adequate.

A person who relies on the record may, however, have a cause of action against the surety company based on its representations that the bond complies with the provisions of Section 212.

SECTION 307. RECORDING CERTIFICATE OF CLERK OF COURT SHOWING SURETY DEPOSIT.

(a) A person who has deposited money or a surety bond with the [clerk of court] in substitution of collateral as provided in Section 213, may record a certificate of the [clerk] showing the deposit.

(b) The certificate must be signed by the [clerk of court], and, if money, state the amount deposited or, if a surety bond, state the amount of the bond and the name and address of the surety company.

(c) The certificate must also state, on the basis of information furnished by the person making the deposit:

(1) the real estate being improved with a description sufficient to identify it;

(2) the name and address of the person in whose behalf the deposit was made;

(3) if a surety bond is deposited, the name and address of a person on whom service of process may be made; and

(4) the name of the claimants for whom the deposit is made, the amount of their claims, and the location of their liens in the record.

COMMENT

Under Section 213 a lien which has attached to real estate may be shifted from that real estate to a surety bond or money deposited with a public official. Under that section, the public official has an obligation to accept the deposit and a resulting obligation to give the certificate referred to in this section. The lien is not shifted from the real estate to the deposit unless the recording authorized by this section is made.

Except as to the amount of money deposited or the amount of the surety bond, all the information on the certificate to be signed by the public official is to be stated by him "on the basis of information supplied by the person making the deposit." That language is used with the intention of relieving the public official from liability in cases in which he is supplied with incorrect or otherwise inadequate information.

SECTION 308. RECORDING CONCERNING JUDICIAL PROCEEDINGS.

(a) A person who has demanded commencement of judicial proceedings to enforce a construction lien (Section 211(b)), may record a copy of the demand in the office in which the lien was recorded. The demand must refer by location in the record to the recorded lien under which it was given, and state the date demand was given to commence a judicial proceeding and the names of the owner and the claimant.

(b) A claimant who has received demand to commence a judicial proceeding may record, in the office in which the construction lien was recorded, a statement that the total contract price is not yet due under the contract for which the lien was recorded. The statement must refer to the recorded lien by its location in the record and state the names of the owner and the claimant.

COMMENT

Under Section 211 an owner may make demand to institute a proceeding to foreclose on a claimant who has recorded a lien and, if the claimant does not, within 30 days, record a statement that his total price is not yet due or institute suit and record a notice of pending proceeding, the lien is discharged. The fact of discharge, however, will not be apparent from the real estate records unless the owner records a copy of his demand and indicates in the record when the demand was made. This section permits recording of the demand and its dates. It also provides for the claimant's recording of a statement that the full price is not yet due. If the claimant institutes suit, he must record a notice of pending proceeding (Section 302).

SECTION 309. OWNER'S STATEMENT OF APPORTIONMENT.

An owner entitled to apportion a construction lien among lots of a platted subdivision of record (Section 203(e)) may record a statement making the apportionment. The statement must refer to the location in the record of the lien being apportioned, state the name of the owner and the claimant, state the date on which the owner demanded the claimant to apportion and that the claimant has not apportioned, and make the apportionment.

COMMENT

Under Section 203, if an owner has recorded a notice of commencement covering more than one lot in a platted subdivision, a claimant may, in recording his lien, apportion the lien to the lots covered by the notice of commencement in any proportion he chooses. If the claimant does not apportion, the owner may make demand that he do so, and, if he does not, the owner may apportion. This section specifies the contents of the owner's notice of apportionment. (See Section 5-203 for the substantive effect of the apportionment.)

SECTION 310. DISCHARGE OF CONSTRUCTION LIEN.

(a) A construction lien provided by this [Act] may be discharged of record by:

(1) recording a signed statement of the record claimant stating that the lien is released;

(2) failing to record, within the time prescribed in the provisions on duration of lien (Section 211), notice of pending proceedings to enforce the lien or an affidavit that the total contract price is not yet due;

(3) recording the original or certified copy of a final judgment or decree of a court of competent jurisdiction so providing; or

(4) recording, as provided in Section 307, a certificate of the [clerk of the court] showing the deposit of substitute collateral.

(b) The construction lien claimant of record by partial release may reduce the amount of the lien claimed in the notice of lien or limit the notice of lien to a portion of the real estate described in the notice of commencement by recording an amendment to the claimant's lien (Section 304) showing the reduction in amount or limited portion of the real estate against which a lien is claimed.

(c) A statement under subsection (a)(1) or a judgment under subsection (a)(3)

must refer by location in the record to the notice of construction lien to which it applies.

COMMENT

1. After a lien has been recorded, it remains effective until it expires by lapse (subsection (a)(2)) or until it is discharged through one of the methods specified in subsections (a)(1), (3), and (4). Under Section 211, a recorded lien lapses one year after it, or an amendment or continuation thereof, was recorded. If a proceeding to foreclose the lien is brought within one year after the last effective recording with regard to the lien, the lien remains effective during the pendency of the proceeding according to the rules applicable to the recorded notices of pending proceedings.

2. If a recorded lien has been discharged by some affirmative act, either of the claimant by release or partial release, by the owner by deposit of collateral, or by judgment of a court, evidence of the discharge must be recorded to clear the record. If the evidence of discharge is not recorded, the lien will expire of record by lapse of time, as already indicated. An amendment of lien which reduces the amount for which a lien is claimed or the real estate against which it is claimed is, of course, a partial release, and it is so described by subsection (b).

ARTICLE 4

ENFORCEMENT OF LIEN

SECTION 401. PROCEEDING TO ENFORCE CONSTRUCTION LIEN.

(a) Except as otherwise provided in this section, the rules applicable to a civil action apply to a judicial proceeding to foreclose a construction lien under this [Act].

(b) In a judicial proceeding to foreclose a construction lien, all claimants having recorded liens may join as plaintiffs and those who do not join as plaintiffs may be joined as defendants. A person who records a construction lien or acquires an interest in real estate after the commencement of the foreclosure proceeding may be made a defendant before judgment.

(c) The court shall determine the amount due or owing to each claimant and direct foreclosure of the construction liens against the real estate. Foreclosure may be by any method available for foreclosure of security interests in real estate, or otherwise, as ordered by the court.

COMMENT

1. This Act does not specify the method of foreclosure to be used in foreclosing construction liens. The court may use the method of foreclosure applicable to security interest (mortgage) foreclosure in the state, or the procedure applicable to realization on judgments, or other available procedure. It is specifically intended that private sale foreclosure be available in the discretion of the judge whether or not it would be available in a judicial foreclosure of a security interest.

2. In the foreclosure proceeding all claimants with recorded liens will be required parties. Those who refuse to join as plaintiffs can be joined as defendants. A claimant may record and claim an interest at any time prior to judgment. If he records after judgment, his interest is subordinate to the rights of those claimants who participated in the foreclosure proceeding.

SECTION 402. RECORDING OF NOTICE OF TERMINATION BEFORE ABANDONMENT OR COMPLETION.

(a) If a contracting owner records a notice of termination (Section 302) before abandonment or substantial completion of all improvements covered by the notice of commencement being terminated, the contracting owner is personally liable to any construction lien claimant to the extent the claimant is unable to realize on the lien because the notice of termination was recorded before abandonment or substantial completion.

(b) A notice of termination is effective even though the owner, under subsection (a), may be personally liable to a construction lien claimant by reason of the owner's recording of the notice of termination.

COMMENT

1. Under subsection (a), a contracting owner may properly record a notice of termination upon substantial completion of all the improvements to which it applied, and, under Section 302, the notice of termination could state a termination date 30 days after its recording. Under Section 208 a lien claimant may record his lien as late as 90 days after his final furnishing of materials or services. Therefore, even though a notice of termination has been properly recorded and the notice of commencement's duration terminated, a lien claimant may still record his lien. However, if he records his lien after the notice of commencement has been terminated, his lien will attach only at the earlier of the time he records his lien or 30 days after the notice of commencement was terminated. (See Section 208). His lien, therefore, will be junior to lien claimants who recorded during the duration of the notice of commencement and to others who acquired interests in the real estate prior to the time his lien attached.

As part of the notice of termination process, it is necessary to publish the notice of termination in a general circulation newspaper and to give notice of it to all claimants who have made a request for notice. (See Sections 302 and 205). Therefore, claimants whose 90-day period for recording has not expired have substantial opportunity to learn of the notice of commencement and to record their lien before the date it terminated the notice of commencement. Because of this opportunity, the Act permits effective termination of a notice of commencement prior to the expiration of the 90-day recording period for lien claimants. There is very little likelihood of abuse of this right since notice of termination procedures are quite onerous and will be used only where there is a substantial business reason for clearing the title early. In such cases, the ability to clear the title 60 days early should reduce transfer delays and the costs and lost opportunities which such delays involve.

2. An owner may record a notice of termination at any time and, if he also records an affidavit that he has complied with the statutory requirements in connection with the notice of termination, third parties who deal with the real estate are fully protected. (See Section 302(c).) If, however, the owner records a notice of termination prior to substantial completion or abandonment of the improvements covered by the notice of commencement, he becomes personally liable to lien claimants "to the extent that the claimant is unable to realize on a lien because the notice of termination was recorded prior to abandonment or substantial completion." A claimant, if the other conditions are present, may recover against the owner personally under this section, even though the claimant had already made his contract at the time the notice of termination was recorded and could have recorded his lien before the termination was effective. That is, a claimant is entitled to assert his lien by recording within 90 days after his final furnishing of materials or services, and, if his lien rights are cut off by prior rights of third parties because of an early recording of a notice of termination, the owner has personal liability to him. The claimant has rights against the owner personally, however, only to the extent that the notice of termination affects his rights. If, even in the absence of a notice of termination, third party rights would have prevented his assertion of a lien, he has no right against the owner under this section. Similarly, if the claimant fails to give notice to the owner under Section 205, so that there is no owner liability, no rights against the owner can arise under this section.

SECTION 403. REMEDIES FOR WRONGFUL CONDUCT.

(a) If a person is wrongfully deprived of benefits arising under this [Act] by conduct other than that described in Section 402 on a contracting owner's duties, the court shall award damages, and may make orders restraining the owner or other person, or ordering them to proceed on appropriate terms and conditions.

(b) If in bad faith a claimant records a lien, overstates the amount for which the claimant is entitled to a lien, or refuses to execute a release of a lien, the court may:

(1) declare the lien void; and

(2) award damages to the owner or any other person injured by the recording, overstating, or refusal to execute a release.

(c) Damages awarded under this section may include the costs of correcting the record and reasonable attorney's fees.

COMMENT

1. Following are some examples of wrongful deprivation of rights which would lead to liability under this section: (1) owner contracts under incorrect name so that claimants are misled as to name in which real estate is held which causes them to record under incorrect name with resulting failure to secure priority against a third party; (2) prime contractor furnishes incorrect owner name with same result; (3) owner or prime contractor furnishes incorrect description of real estate with resultant mistaken recording by claimant; (4) misstatement by prime contractor as to amount of contract price or payment thereof which induces claimants not to record lien; (5) false or bad faith determination of damages from a prime contractor's breach which reduces the owner's lien liability.

It is not wrongful for a lien claimant to induce the owner to pay his claim even though the claimant is aware of other claimants who have not been paid, whether or not the other claimants have recorded a lien or notified the owner.

2. If a claimant in bad faith records a lien or overstates his lien, he loses his lien and is liable in damages. If the overstatement or improper recording is in good faith, the lien is not lost. However, the claimant in such a case, depending on the circumstances, may have deprived

another claimant, third party, or the owner of rights to which they are entitled under the Act, and, if so, will be liable in damages to the person deprived of rights.

3. Under subsection (c), the court in its discretion may award attorney's fees against a party who is found to be liable under this section. If, for example, a claimant is found to have overstated the amount of its lien claim in bad faith, the judge could award attorney's fees to the owner or other party harmed. This Act does not generally allow attorney's fees to the prevailing party (see, however, Section 212 which does allow attorney's fees to the prevailing party in an action on a surety bond). However, if other existing law of the state would apply to allow attorney's fees to the prevailing party in a proceeding under this Act, this Act is not intended to supersede such law.

ARTICLE 5

TRUST FUNDS RELATING TO REAL ESTATE IMPROVEMENTS

SECTION 501. CREATION OF TRUST IN CONNECTION WITH A REAL ESTATE IMPROVEMENT CONTRACT.

(a) The funds described in subsections (c), (d), or (e) received in connection with a real estate improvement constitute assets of trusts which are charged with the burden of paying the cost of the improvement to the same extent as the real estate being improved or benefitted is subject to a construction lien.

(b) A construction lien continues as additional security for the obligations it secures.

(c) Assets of a trust of which the owner is trustee are the funds received and the right to payment of funds:

(1) under a construction mortgage;

(2) under a mortgage recorded subsequent to the commencement of the improvement and before expiration of the period during which a construction lien must be recorded pursuant to Section 208; or

(3) as consideration for a conveyance recorded subsequent to the commencement of the improvement and before expiration of the period during which a construction lien must be recorded pursuant to Section 208.

(d) Assets of a trust of which a prime contractor is trustee are the payments received and the right to payment under a real estate improvement contract, whether or not earned by performance, and under an assignment of funds due or earned or to become due or earned under the contract.

(e) Assets of a trust of which a subcontractor is trustee are the payments received by the subcontractor and the subcontractor's right to payment under the subcontract whether or not earned by performance, and under an assignment of the funds due or earned or to become due or earned under the subcontract.

(f) Except as provided in subsections (g) and (h), use by a trustee of any assets of a trust for other than trust purposes, before all claims, except those that are subject to a bona fide dispute, have been paid in full constitutes a breach of trust and a misappropriation of assets of the trust.

(g) A trustee who is an owner of the real estate being improved may use assets of the trust to pay the trustee's own expenses incurred in connection with the real estate improvement, including land costs and that portion of the general operating expense of the trustee's business reasonably allocable to the real estate improvement. A trustee who is a prime

contractor or subcontractor may use assets of the trust to pay the trustee's own expenses incurred in connection with providing services or materials for the real estate improvement, including that portion of the general operating expense of the trustee's business reasonably allocable to the contract under which the services or materials are provided. Payments made under this subsection, for the purposes of subsection (k), are treated in the same manner as payments for any other purpose of the trust.

(h) A trustee does not commit a breach of trust or misappropriate trust funds by applying funds to nontrust purposes if the assets of the trust remaining after the application are sufficient to pay all amounts payable from the assets of the trust at that time and all amounts the trustee could reasonably anticipate will be payable from those assets in the future.

(i) If a trustee is a corporation, any of its officers, directors, or agents who are responsible for misappropriation of assets of the trust are subject to the penalties for breach of trust.

(j) A trustee need not keep separate trust accounts, but the trustee's books must show clearly the allocation to each trust of the funds deposited and withdrawals made with sufficient clarity to establish that any disbursements were consistent with the trust obligations.

(k) A trustee need not select any particular order of payment or division of assets of the trust or manner of payment of any trust claims or apply any assets of the trust to any particular purpose of the trust.

(l) A person making payment has no obligation to see to the proper application of funds by the owner, prime contractor, or subcontractor.

(m) Except as provided in this section, the remedies available for and the penalties applicable to breach of trust are the same as provided in other law or in equity.

COMMENT

1. This section creates a trust in certain money paid or due to the owner, prime contractor, or subcontractors. The existence of a trust has three significant effects: (1) A failure to apply the assets of the trust to payment of the claims of the beneficiaries will result in criminal liability for theft or embezzlement under the law of most, if not all, states. (2) The law applicable to rights of third parties as against beneficiaries of a trust will determine whether third parties who deal with the trustee, such as takers of security interests or judgment creditors, have priority over the beneficiaries of the trust as to trust assets. (3) Individual corporate officers or other agents who participate in a diversion of trust funds to nontrust purposes may become personally liable to beneficiaries who remain unpaid.

2. As against a contracting owner, any person who could claim a lien on the owner's real estate is a beneficiary of the trust. As against a prime contractor or subcontractor, any person who could claim a lien against the real estate, and who claims his lien through the particular prime contractor or subcontractor is a beneficiary of the trust. The section does not specifically describe the beneficiaries of the trust: the statutory language is that the trust assets "are charged with the burden of paying the cost of the improvement to the same extent as the real estate being improved or benefitted it subject to a construction lien." The intent of that language is not that a trust exists only if the particular claimant could, at the time he makes a claim against the trust, assert a lien. If, for example, the owner discharges its lien liability in full by paying the prime contractor before any subcontractors or materialmen give notice of lien liability, subcontractors could, nevertheless, assert a breach of trust claim against a contractor who had failed to pay subcontractors from trust assets. On the other hand, a contracting owner who has no possible lien liability because it properly paid the prime contractor without notice of lien claims of any subcontractor, is not liable for breach of trust if it refuses to pay lien claimants from proceeds of sale from a conveyance recorded before the expiration of the period during which a lien could be filed. It is not the intent of the section that the liability of a contracting owner be expanded beyond the liability it would incur under its contract and under the construction lien provisions of this Act.

3. The trust assets of which the owner is trustee are specified in subsection (c). The assets there described are funds borrowed on a construction mortgage to finance the project, and funds received or due from a mortgage or conveyance recorded after the commencement of the improvement and prior to the expiration of the period during which a construction lien could be filed. The two later sources of trust assets are justified on the assumption that the owner usually is able to receive a higher price or greater loan amounts because the lender or buyer in the situation described is taking into account the value added by the improvements in determining loan amount or price.

Money borrowed by the owner and not secured by a mortgage on the property does not constitute part of the trust even though the owner and the lender understand that loan proceeds will be used to pay for the construction.

4. The trust assets of which contractors and subcontractors are trustees are money they receive from the person with whom they contracted to perform the services and their right to be paid. The trust exists as to payments not yet paid under the contract whether or not the work for which the payment will be due has yet been performed.

5. The trust arises even though, before performance, the contractor or subcontractor, has assigned the right to be paid to some third party. Since the right to be paid is trust assets and not property of the contractor or subcontractor, an assignment would be ineffective unless under the law of the state applicable to trusts generally, the court concludes that the assignee prevails as against beneficiaries of the trust. See Restatement of Contracts, 2d, Section 343 and IV A.W. Scott, *The Law of Trusts*, 3d ed., Section 283 ff(1967). See also the following representative cases which involve rights of third parties as against beneficiaries of statutory trusts created for construction lien claimants: *Nat. Bank of Detroit v. Eames & Brown*, 396 Mich. 611, 424 NW 2d 412 (1976); *Sandpiper North Apartments, Ltd. v. American Nat. Bank & Trust Co. of Shawnee*, 680 P.2d 983 (Okla. 1984); *Kraemer Bros., Inc. v. Pulaski State Bank*, 138 Wis.2d 395, 406 N.W.2d 379 (1987).

6. Subsection (g) permits trustees to pay their own expenses relating to the improvement, including overhead costs which are "reasonably allocable" to the project, out of trust proceeds. Under subsection (k), a trustee properly applies trust assets if it applies the assets to any trust purpose and need not pro rate payments in case there is a shortage. Therefore, so far as trust liability goes, a trustee can pay its own expenses even though the payment leaves insufficient trust assets to pay other beneficiaries. There is no requirement here that the trustee must put the interests of other beneficiaries ahead of, or on a par with, his own interests. This rule is, of course, only for the purposes of liability as trustee: it does not affect the contract or construction lien liability of the owner or the contract liability of contractors or subcontractors.

7. Subsection (h), like subsection (g), ameliorates the impact of the trust fund rules on the trustee. Under that section, the trustee can use trust funds for nontrust purposes if the assets remaining are sufficient to pay all trust claims which exist or which the trustee can reasonably expect will exist in the future. In this connection, the right to be paid in the future for work not yet done is a trust asset. If, therefore, for example, a prime contractor receives a first progress payment of \$100,000 on a one million dollar contract, the contractor could apply that entire \$100,000 to nontrust purposes such as payment of a dividend to stockholders, if the total amount which is due or reasonably anticipated to come due to subcontractors is \$900,000 or less. If, in fact, the project later fails because of the owner's inability to continue, the prime contractor will have no breach of trust liability. Of course, the prime will have whatever contract liability to subcontractors he has undertaken.

8. As noted above in relation to the trustee's ability to pay for its own expenses in relation to the project out of trust funds, there is no obligation to pay out trust proceeds in any particular order. Therefore, if the trustee pays to a person who is given the right to assert a lien under the Act, and, in the case of a contractor or subcontractor, who claims through the particular contractor or subcontractor, the payment has been properly made for trust purposes even though it may not have been properly made for purposes of the discharge of lien liability against the real estate. The reason for permitting the trustee greater latitude in complying with trust obligations is the existence of criminal and personal liability for breach of trust.

ARTICLE 6

EFFECTIVE DATE AND REPEALER

SECTION 601. EFFECTIVE DATE.

This [Act] takes effect on _____. It applies to transactions entered into and events occurring after that date.

SECTION 602. PROVISIONS FOR TRANSITION.

The rights, duties, and interests flowing from the performing of any labor or the furnishing of any material before the effective date specified in Section 601 remain valid after that date and may be terminated, completed, consummated, or enforced as required or permitted by any statute or other law amended or repealed by this [Act] as though the amendment or repeal had not occurred.

SECTION 603. REPEALS.

The following acts and parts of acts are repealed:

- (1)

(2)

(3)