



CONSTRUCTION LAW
Update

Fall 2004

Registration Deadline Approaching for Home Improvement Contractors

The Contractors' Registration Act (N.J.S.A. 56:8-136 et seq.) becomes effective on November 9, 2004.¹ The Act requires, for the first time in this State, all contractors engaged in selling or making home improvements to register annually with the New Jersey Division of Consumer Affairs. As of November 9, no municipality will issue a building permit to any home improvement contractor who is not so licensed. The Act preempts local ordinances requiring licensing or registration of such contractors, but does not affect a municipality's power to inspect a home improvement contractor's work or to regulate the standards governing such work.

The Act applies to all contractors engaged in selling or performing home improvements in New Jersey, even if the contractor's residence or principal place of business is located outside the State. A home improvement is defined to mean the remodeling, altering, renovating, repairing, restoring, modernizing, moving, demolishing or otherwise improving or modifying the whole or any part of any residential or non-commercial property, and also includes insulation installation and the conversion of existing commercial structures into residential or non-commercial use. Residential or non-commercial property is defined as any single or multi-unit structure used in whole or in part as a residence, all structures appurtenant thereto, and any portion of the lot or site on which such a structure is situated.

As such, the Act would appear to cover contractors who, traditionally, may not have thought of themselves as home improvement contractors, such as painters, landscapers, swimming pool installers, persons installing wall-to-wall carpeting, and persons repairing sidewalks or driveways, including, arguably, college students sealing driveways as a summer job, depending on whether the contract price exceeds \$500. The Act also may affect certain customary practices. For instance, small landlords no longer may be able to require their tenants to make improvements or repairs to their apartments, unless the tenant is a registered home improvement contractor or the value of the work and materials is less than \$500.

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Timing is Critical in Perfecting Construction Liens on Residential Projects

Construction liens can be a powerful tool, in addition to or in lieu of a collection action directly against the other contracting party, to secure payment for completed work. If the other contracting party has become insolvent, a construction lien may be the only hope for an unpaid contractor, subcontractor or supplier to get paid. A perfected construction lien results in a lien on the owner's real property that can be foreclosed like a mortgage. The possibility of such foreclosure has precipitated resolution of payment claims on many construction projects. However, what many contractors and subcontractors may not realize is how critical timing can be when filing a construction lien claim, particularly on residential projects.

The New Jersey Construction Lien Law, N.J.S.A. 2A:44A-1 et seq. (the "Lien Law") controls the filing and prosecution of construction liens. The Lien Law authorizes unpaid contractors, subcontractors, sub-subcontractors and suppliers to file construction liens against the owner's real property, but only under specific circumstances and pursuant to specific procedures. The Lien Law sets forth:

1. What is required for a party to be entitled to a construction lien (a written contract setting forth a contract price, which can be fixed or variable);
2. How the construction lien claim is filed (the statutory form is filed with the County Clerk in the county where the project property is located and served on the owner and the debtor party); and
3. When the construction lien claim must be filed (within 90 days of the last day work is performed on the project for which payment is claimed).

The 90-day time period is a strict requirement of the Lien Law. Unfortunately, that period frequently passes before contractors, subcontractors and suppliers even realize that they are not going to be paid.

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The Act also requires home improvement contractors to maintain commercial general liability insurance in a minimum amount of \$500,000 per occurrence. Registration may be refused, suspended or revoked upon proof that a contractor has engaged in acts of dishonesty, fraud, deception, gross negligence or repeated acts of negligence, or has been convicted of or plead guilty or *nolo contendere* to any crime involving moral turpitude or relating adversely to the activity regulated by the Act.

The Act also requires every home improvement contract in excess of \$500, and any amendments to such contract, to be in writing, and that the language used in the contract must be clear and understandable. All such contracts must contain a provision, conspicuously printed in at least 10-point bold-faced type, notifying the consumer of the absolute right to cancel the contract without penalty before midnight of the third business day after receiving a copy of the contract. If the contract is cancelled, all monies previously paid by the consumer to the contractor must be refunded within thir-

ty days of receipt of notice of cancellation. Home improvement contracts are also required to include: the legal name, business address and registration number of the contractor; a copy of the contractor's certificate of insurance and the telephone number of the insurance company issuing the certificate; and the total price to be paid by the consumer, including any finance charges. There is no requirement for bonding, or any minimum warranty requirements that must be included in a home improvement contract.

The only exceptions to registration under the Act are for persons required to register pursuant to the New Home Warranty and Builder's Registration Act (N.J.S.A. 46:3B-1 et seq); persons performing a home improvement upon property that they own, or that is owned by a family member, a bona fide charity or other non-profit organization; persons in regulated professions or trades, such as architects, engineers, landscape architects, electrical contractors, master plumbers or any other profession or trade requiring registration, certification or licensure by the State; persons employed by community associations or cooperatives; persons licensed under the

Home Repair Financing Act (N.J.S.A. 17:16C-77); large home improvement retailers having a net worth greater than \$50 million, such as Home Depot and Loews, and their employees; and public utilities.

Any person who violates the Act is subject to the provisions of the New Jersey Consumer Fraud Act (N.J.S.A. 56:8-1 et seq), which subjects the violator to liability for treble damages and attorneys' fees. A knowing violation of the Act is a crime of the fourth degree. ■

¹At the time that this Update was printed, legislation (Assembly Bill 3258) was pending to defer the deadline for registration under the Act until December 31, 2005. Although it appeared likely that the legislation would be enacted, it was not clear whether that would occur before November 9, 2004. The Division of Consumer Affairs maintained the position that unless the legislation was enacted prior to November 9, building permits would be denied to any home improvement contractor who was not registered by that date. See <http://www.state.nj.us/lps/ca/contractor.htm>. However, on September 23, 2004 the Director of the Division of Codes and Standards of the New Jersey Department of Community Affairs issued a letter to all local construction code officials refuting that position and advising that no action should be taken to enforce the registration requirement of the Act (i.e., deny a building permit to a home improvement contractor who has not registered under the Act) until further notice from his office.

The Effect of "Pay-When-Paid" Clauses

"Pay-when-paid" clauses, sometimes couched in terms of "pay-if-paid," are commonplace in subcontracts involving private sector construction projects. For example, the American Institute of Architects ("AIA") Standard Form of Agreement Between Contractor and Subcontractor (AIA Document A401-1997 edition) provides, in pertinent part, that:

12.1 Final payment, constituting the entire unpaid balance of the Subcontract Sum, shall be made by the Contractor to the Subcontractor when the Subcontractor's Work is fully performed in accordance with the requirements of the Subcontract Documents, the Architect has issued a certificate for payment covering the Subcontractor's completed Work, and the Contractor has received payment from the Owner. [Emphasis supplied.]

Subcontractors awaiting payment under such a clause are faced with the following questions:

- What is the contractor's obligation to pay the subcontractor when the contractor has not received payment from the owner for reasons unrelated to any problem with the subcontractor's work?
- Does a "pay-when-paid" clause create a condition precedent to the subcontractor's

right to payment, or merely affect the timing of payment to the subcontractor?

There is no precedential authority in New Jersey that dispositively answers these questions. However, an unpublished opinion of the New Jersey Superior Court, Appellate Division, is instructive. In Avon Bros., Inc. v. Tom Martin Constr. Co., Inc., A-740-99T1 (N.J. Super., App. Div. Aug. 30, 2000), the Appellate Division addressed the proper interpretation and enforcement of "pay-when-paid" clauses as a matter of first impression in New Jersey.¹ Coincidentally, the particular clause reviewed by the Court in Avon Bros. was paragraph 12.1 of AIA A401.

Citing substantial support from numerous jurisdictions, the Court held that in the absence of clear and unequivocal language indicating the parties' intent to shift the risk of non-payment by the owner ("collection risk") from the contractor to the subcontractor, a "pay-when-paid" clause merely governs the timing of payment to a subcontractor, and is not a condition precedent to a subcontractor's right to payment from the contractor. Noting that a shifting of collection risk is contrary to the usual allocation of construction risks between a contractor and a subcontractor, the Court also opined that the use of "pay-if-paid" instead of "pay-when-paid" language, in and of itself, may not be sufficient to manifest a clear intention to shift such

risk from the contractor to the subcontractor.

As to the timing of payment, the Court eschewed any bright-line rule and held that a "pay-when-paid" clause merely permits a "reasonable postponement" of the contractor's payment obligation. According to the Court, a reasonable time for postponement of payment includes the time within which the contractor is actively pursuing collection and while there remains a reasonable likelihood of collection of payment from the owner. In other words, each case will turn on its own facts and circumstances. Once a reasonable time has passed, however, the subcontractor is entitled to payment from the contractor even if the contractor has not received payment from the owner, provided, of course, that the reason for nonpayment by the owner is not related to any problems with the subcontractor's work.

Citing authority that two years is more than a reasonable time for a subcontractor to wait for payment under such circumstances, the Court concluded that a reasonable time had elapsed in the case before it based upon the fact that the subcontractor's work had been completed and the underlying shopping center project had been opened for business for more than three years prior to the subcontractor filing suit.

Additional questions that arise when a subcontractor is awaiting payment under a "pay-when-paid" clause are

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Recovery of Damages for Delay

The myriad causes of delay on construction projects include: failure to provide timely access to the work; directing work out of sequence; differing site conditions; unforeseen subsurface conditions; unusually severe weather; force majeure; excessive change orders; untimely review and approval of shop drawings and other submittals; and lack of coordination of multiple prime contractors. The myriad impacts of delay include: increased labor and equipment costs; extended field and home office overhead; inefficiency/lost productivity; acceleration; loss of potential bonus for early completion and; lost profits and other consequential damages. Provisions allocating the risk of delay are commonplace in contracts and subcontracts involving public and private sector construction projects in New Jersey, distinguishing between delays that are excusable and inexcusable, and compensable and non-compensable.

Excusable delay typically is defined as delay which is not the result of any fault, neglect or breach of the contractor or anyone for whose acts or omissions the contractor is responsible, including its subcontractors. Unless the contract expressly provides otherwise, examples of excusable delay may include differing site conditions, unforeseen subsurface conditions, unusually adverse weather, and force majeure. In some instances, excusable delay also must be “critical” and “non-

concurrent.” In the event of an excusable delay, the contractor usually is entitled to an extension of time for performance, and may be entitled to compensation for some or all of the damages incurred as a consequence of such delay. However, delays which are inexcusable do not entitle the contractor to any extension of time, and may expose the contractor to damages or liquidated damages if the project is not completed on time.

A “no damages for delay” clause is a form of exculpatory clause that limits a contractor’s remedy for excusable delay to an extension of time, and prohibits the recovery of any costs or damages incurred as a consequence of such delay. Although these clauses initially appeared in public construction contracts, to protect taxpayers when public agencies contract for public improvements on the basis of fixed appropriations or loan commitments, they are now prevalent in private sector construction contracts as well.

A typical “no damage for delay” clause provides as follows:

If the Contractor is delayed in completion of the work by any act or neglect of the Owner, Architect, or any other Contractor employed by the Owner, or by changes ordered in the work, or by strikes, lockouts, fire, unusual delay by common carriers, unavoidable casualties, or by any cause beyond the Contractor’s control, or by any cause which the Architect shall decide to justify the delay, then for all of such delays and suspensions the Contractor shall be allowed one day additional to the time limitations herein stated for each and every day of such delay so caused in the completion of the work, the same to be ascertained solely by the Architect, and a similar allowance of extra time will be made for such other delays as the Architect may find to have been caused by the Owner. Apart from extension of time, no

payment or allowance of any kind shall be made to the Contractor as compensation for any costs or damages on account of hindrance or delay from any cause in the progress or completion of the work, whether such delay be avoidable or unavoidable.

In the public sector, the enforceability of “no damages for delay” clauses in contracts involving State and local construction projects is strictly limited by statute. The State and its agencies and instrumentalities cannot prohibit contractors from recovering damages for delays caused by the public entity’s “negligence, bad faith, active interference, or other tortious conduct,” but may prohibit contractors from recovering damages for delayed performance caused by “reasons contemplated by the parties.” N.J.S.A. 2A:58B-3 (L. 1994, c. 80, §1, eff. July 28, 1994). Similarly, counties, municipalities and other local contracting units, including boards of education, cannot prohibit contractors from recovering damages for delays caused by the contracting unit’s “negligence, bad faith, active interference, tortious conduct, or other reasons contemplated by the parties.” N.J.S.A. 40A:11-19 (L. 2001, c. 206, §1, eff. Aug. 8, 2001); N.J.S.A. 18A: 18A-41 (L. 2001, c. 206, §2, eff. Aug. 8, 2001). In ascertaining what delays may have been contemplated by the parties, a court will review the contract documents as a whole, and may even resort to custom and course of dealing between the parties.¹ Obviously, each case turns on its own particular facts and circumstances.

By virtue of these statutes, any provision in a construction contract with the State or local contracting units that broadly limits a contractor’s remedy to an extension of time for performance, or

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Construction Liens... continued from page 1

The 90-day time period is particularly critical on residential projects. A residential project is defined as one which involves the construction of or improvement to a one- or two-family dwelling, or any portion thereof, and includes any residential unit in a condominium, housing cooperative, fee simple town house development, horizontal property regime and planned unit development. The distinction between a residential project and a commercial project is not drawn based on the identity of the party with whom the lien claimant contracts. A masonry subcontractor installing brickwork on a Toll Brothers’ residential project has to follow the same rules for filing a construction

lien as a mason contracting directly with a homeowner to construct a patio.

The Lien Law imposes a number of special prerequisites that the claimant must follow before a construction lien claim can be filed in connection with a residential project. These special prerequisites, culminating in and including the filing of the construction lien claim, all must be completed with the 90-day period:

1. The claimant must file a form known as a NUB (a Notice of Unpaid Balance and Right to File Lien Claim) and serve it, together with a demand for arbitration before the American Arbitration Association;

2. The matter is then referred to and heard by a single arbitrator. Upon conclusion of the hearing, the arbitrator has 30 days to make certain rulings regarding the validity and amount of the lien claim; and
3. If the arbitrator rules in favor of the claimant, the claimant only then may file and serve its construction lien claim in the approved amount, provided it is still within the 90-day period.

The Lien Law is not a panacea that will guarantee receipt of payment in all cases. Nonetheless, contractors, subcontractors and suppliers who fail to pursue and perfect their lien rights in timely fashion unnecessarily handicap themselves in the fight for payment. ■

whether and when the subcontractor should file a construction lien claim to protect its lien rights.

The filing of a construction lien claim by an unpaid subcontractor is governed by the New Jersey Construction Lien Law, N.J.S.A. 2A:44A-1 et seq. (the "Lien Law"). For non-residential private construction projects, the Lien Law requires that a lien claim be filed not later than 90 days following the date the last work, services, material or equipment was provided for which payment is claimed. N.J.S.A. 2A:44A-6. Moreover, an action to enforce such lien claim must be filed not later than one year after the date of the last provision of work, services, material or equipment for which the lien claim was filed. N.J.S.A. 2A:44A-14a(1).

These limitations period are strictly enforced and should be observed regardless of whether a subcontractor is subject to a "pay-when-paid" clause, or whether a reasonable time for postponement of the contractor's payment obligation has elapsed. If the trial court should find that the subcontractor is otherwise entitled to payment (i.e., that the subcontractor's acts or omissions are not the cause for non-payment), but that a reasonable time has not elapsed, the court may enter judgment on the lien claim but stay execution on the judgment pending the expiration of such period. ■

¹ Although the interpretation and enforcement of pay-when-paid clauses was the subject of an earlier decision by the United States District Court for the District of New Jersey (*Seal Tite Corp. v. Ehret, Inc.*, 589 F Supp. 701 (D.N.J. 1984)), that decision is not dispositive of a question of New Jersey law.

prohibits the recovery of damages for any and all delays, is against public policy and is void and unenforceable. On the other hand, these statutes do not prevent the State or local contracting units from narrowly limiting a contractor's remedy to an extension of time for delays caused by, for example, unusually adverse weather, differing site conditions, unforeseen subsurface conditions, force majeure and other casualties or causes beyond the contractor's control, or the negligence, active interference or other tortious conduct of third parties, including other co-prime contractors, either directly or by means of language which makes it clear that the potential for such delays was contemplated by the parties. These statutes also do not prevent the State or local contracting units from limiting the damages recoverable for delay from any cause to liquidated damages or direct damages, and from excluding recovery of consequential damages under all circumstances. The State and local contracting units also are not prevented from requiring very short written notice of delays as a condition precedent to recovery of any damages, or from requiring mediation or arbitration of all claims involving delay damages.

There are no statutes similar to those discussed above that limit the enforceability of "no damages for delay" clauses in private sector construction contracts. To date, no New Jersey court has held that the public policy limitations expressed in those statutes also apply in the private sector. However, as a general rule,

exculpatory clauses in private contracts are valid and enforceable provided only that they are not adhesive in nature, do not operate to exculpate a party who is under a public duty to perform, do not violate public policy and otherwise are not unconscionable.² Thus, in private contracts, exculpatory clauses may excuse or limit a party's liability for negligent or even grossly negligent contract performance, but will not bar a claim for damages based on a party's willful and wanton misconduct, which is tantamount to bad faith, active interference or other tortious conduct.³

At the present time, therefore, it would appear that the owner of a private sector construction project can prohibit a contractor from recovering damages for delays caused by the owner's negligent acts or omissions, whereas the State and local contracting units cannot. Otherwise, by utilizing carefully drafted "no damages for delay" clauses, both the State and local contracting units and private owners can preclude their contractors from recovering damages for virtually all delays except those delays caused by the owner's bad faith, active interference or other tortious conduct. ■

¹ See, e.g., *P.T.&L. Const. v. Dept. of Transp.*, 108 N.J. 539, 562-64 (1987); *Broadway Maintenance Corp. v. Rutgers*, 90 N.J. 253, 268-70 (1982); *Ace Stone, Inc. v. Wayne Tp.*, 47 N.J. 431, 437-28 (1966); *Edwin J. Dobson, Jr., Inc. v. State*, 218 N.J. Super. 123, 128-30 (App. Div. 1987).

² See, e.g., *Tessler and Son, Inc. v. Sonitrol Sec. Systems of Northern New Jersey, Inc.*, 203 N.J. Super. 477, 482-83 (App. Div. 1985).

³ *Id.* at 484-85.

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