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NAVIGATING THE ENFORCEMENT OF MECHANICS' LIENS IN BANKRUPTCY¹

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Perfecting a mechanic's lien under Nevada law requires a claimant to take specific steps pursuant to Chapter 108 of the Nevada Revised Statutes (NRS) to:

1. Record its notice of lien,²
2. Properly serve the notice of lien,³ and
3. Foreclose on the mechanic's lien through court action.⁴

However, when a bankruptcy is filed, compliance with these steps becomes difficult, because key provisions of the Bankruptcy Code modify some of the basic concepts generally understood to be true in the area of mechanic's lien law, and they create potential traps for the unwary claimant and/or the claimant's attorney.

Perfecting a Mechanic's Lien After a Bankruptcy Filing

Despite a claimant's compliance with state mechanic's lien law, its right to enforce its lien can be at risk if the debtor files a petition for relief under one of the chapters of the Bankruptcy Code. A frequent scenario arises when a claimant who has provided goods and/or services for a construction project, but who has not yet been paid and/or perfected its mechanic's lien, is notified that the owner of

the project has filed a bankruptcy petition. Upon the filing of the bankruptcy petition, the "automatic stay" under 11 U.S.C. Section 362(a)(4) arises, prohibiting "any act to create, perfect or enforce a lien against the property of the estate." This provision might appear to require that all efforts to perfect and enforce a mechanic's lien be halted. However, Bankruptcy Code Section 362(b)(3) specifically carves out an exception for perfecting a mechanic's lien after the filing of the petition by providing that the automatic stay does not apply to "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to perfection under § 546(b) of [the Bankruptcy Code]."⁵

Bankruptcy Code Section 546(b)(1) restricts a trustee's powers to avoid liens by limiting such powers as subject to any "generally applicable law" that would permit "perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection." Based on this provision, most bankruptcy courts hold that state mechanic's lien statutes allowing a supplier of labor and materials to assert a lien, relating back to the time such labor or materials were first provided, fall within the scope of Section 546(b)(1) and are not stayed under Section 362(a)(4).

Under Nevada law, a mechanic's lien may relate back to a date before the filing of a bankruptcy petition, if that date occurred when the labor and materials were originally supplied;⁶ therefore, the act of recording and perfecting a

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mechanic's lien is not subject to the automatic stay in bankruptcy. Nevertheless, a claimant may still want to seek an order from the bankruptcy court prior to taking such an action and should also file a proof of claim on account of its lien.

Foreclosing a Mechanic's Lien After a Bankruptcy Filing

Notwithstanding the perfection of a mechanic's lien, either before or after the filing of the bankruptcy petition, a claimant's ability to initiate or continue a suit to foreclose on the mechanic's lien is impacted by the automatic stay. The Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals has held that the commencement of a foreclosure suit by the claimant on a mechanic's lien after the filing of a bankruptcy petition violates the automatic stay of Bankruptcy Code Section 362.⁷ This holding creates a major problem for claimants in Nevada, because state law requires the commencement of a foreclosure lawsuit within six months from the date the lien is recorded.

To address this roadblock, a claimant may seek relief from the automatic stay to commence or continue an action to enforce its lien by filing a motion with the bankruptcy court. Alternatively, a claimant may preserve its rights to foreclose on its lien by taking the substitute action of giving notice of its right to enforce the mechanic's lien: an action specifically allowed under Bankruptcy Code Section 546(b)(2). This notice should be filed in a bankruptcy case within the same time frame that a claimant would be required to commence its action to foreclose the mechanic's lien under Nevada state law: six months from the date that the mechanic's lien was originally recorded.⁸

Notice of a Right to Enforce a Mechanic's Lien Under § 546(b)(2)

Despite the Bankruptcy Code's provision for the filing of a notice by a mechanic's lien claimant, the Bankruptcy Code is devoid of any guidance as to what constitutes the requisite notice. Accordingly, the notice requirements under Section 546(b)(2) differ in each jurisdiction and, unfortunately, there are no reported cases in Nevada dealing with the sufficiency of the Section 546(b)(2) notice for liens arising here.

However, the Ninth Circuit Court of Appeals has opined as to what conduct is insufficient for such notice. In the case of *In re Baldwin Builders*, 232 B.R. 406 (9th Cir. B.A.P. 1999), the Ninth Circuit concluded that the mere filing of a Proof of Claim for a secured debt is not enough to satisfy the Section 546(b)(2) notice to maintain the mechanic's lien, nor is the recording of the lien itself. The court ruled that more must be done by a claimant to maintain the perfection of a mechanic's lien or it will expire within the statutory six-month period.⁹ The guiding principle of the *Baldwin Builders* decision appears to be that the notice given by a claimant should inform the court and the debtor that the claimant would have commenced the foreclosure action, had the bankruptcy not prevented such action.

Some courts have held that oral notice or out-of-court action evidencing an intent to assert and enforce a lien can be sufficient, but most have concluded that Section 546(b)(2) requires that a writing be filed in the bankruptcy case.¹⁰ A claimant should, at a minimum, file a pleading in the bankruptcy case expressly providing that:

1. The claimant has a right to assert a mechanic's lien under applicable state law;
2. It intends to assert and enforce such a lien; and
3. It is authorized to do so under Bankruptcy Code provisions.

The filing of this notice should preserve the claimant's lien rights throughout the duration of the bankruptcy case.

Tolling of the Foreclosure Deadline During a Bankruptcy Case

If a claimant has otherwise properly preserved its lien, a majority of courts, including the Ninth Circuit Court of Appeals, agree that Bankruptcy Code Section 108 tolls the deadline for commencing a foreclosure action to enforce a mechanic's lien.¹¹ Thus, a claimant who timely records a mechanic's lien under Nevada law and files the required notice under Section 546(b)(2) in the bankruptcy case in lieu of commencing a foreclosure action, has at least 30 days after the termination of the automatic stay (which may occur upon dismissal of the case or abandonment or surrender of property), to commence or continue its foreclosure action.¹² However, it should be noted that Section 108(c) of the Bankruptcy Code only operates to toll the time period for commencing or continuing a civil action to foreclose the mechanic's lien; it does not extend the time period for filing the original lien or the Section 546(b)(2) notice discussed above.

Conclusion

In light of the foregoing, mechanic's lien claimants should seek legal counsel if they have provided labor and materials with respect to a construction project and the property owner files for bankruptcy protection. In order to properly assert, perfect and maintain their lien during a bankruptcy case, they must carefully follow the requirements of both Nevada's mechanic's lien statute and the Bankruptcy Code. **NL**

1. This article assumes that the debtor is the owner of the real property for which the services and/or materials were provided. Different issues may arise if the debtor is not the owner, but rather a general contractor on the construction project. This article does not address such issues.
2. NRS 108.226.
3. NRS 108.227.
4. NRS 108.223; NRS 108.239.
5. *In re Omdorff Construction, Inc.*, 394 B.R. 372 (Bankr. Ct. M.D.N.C. 2008) ("An action to perfect a materialman's lien is excepted from the

automatic stay by Section 362(b)(3)"). See also *In re Richardson Builders, Inc.*, 123 B.R. 736, 738 (Bankr. W.D. Va. 1990); *In re Victoria Grain Co. of Minneapolis*, 45 B.R. 2, 6 (Bankr. Minn. 1984).

6. NRS 108.222 (amount of lien); NRS 108.225 (a lien under this chapter is preferred to any lien recorded after the commencement of construction of a work of improvement).
7. *In re Baldwin Builders*, 232 B.R. 406 (9th Cir. B.A.P. 1999).
8. NRS 108.223.
9. NRS 108.223; *In re In re Baldwin Builders*, 232 B.R. at 413-14.
10. See *In re Baldwin Builders*, 232 B.R. at 413-14 (collecting cases).
11. *In re Hunters Run Ltd. Partnership*, 875 F.2d 1425 (9th Cir. 1989).
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