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September 28, 2001

Jerry Crane, Credit Manager
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Re: Lien Law Manual Article on New York Law

Dear Jerry:

Enclosed please find my submission for your trade industry Lien Law Manuel. As you can see, I have included copyright marks to discourage plagiarism. Of course I have no objection to the article being included in your Manuel, so long as it includes the copyright marks to discourage anyone else from calling it their own.

I would appreciate having a copy of the new Manuel when available. Please send me a copy when it comes out.

Thanks for the opportunity to contribute to your project. Please do not hesitate to call if you have any questions or concerns. We look forward to serving you again soon.

Very truly yours,



Robert A. Dean

MECHANIC'S LIENS AGAINST OIL & GAS WELLS IN NEW YORK

1. Preface: Mechanic's Liens in the State of New York are governed by the New York Lien Law (herein the "Lien Law") which establishes the procedure for filing Mechanic's Liens in general, as well as Statutes governing Trust Funds, Building Loan Agreements, and various other construction related activities. While an understanding of these interrelated laws, the Real Property Law, and the Real Property Actions and Proceedings Law is needed in many cases to effect any recovery, it is beyond the scope of this outline to review this extensive law. Rather this outline is intended to provide a general guideline for when and how Mechanic's Liens may be successfully filed in New York. Of course a general guideline cannot take into account the myriad of factual circumstances that may have a bearing upon any particular claim, so this outline does not give you any legal advice. You should consult with your legal advisor about your claim before deciding whether or not or how to file a Mechanic's Lien.

2. Introduction: In New York a creditor may file a Mechanic's Lien under the appropriate circumstances in order to become a secured creditor. A Mechanic's Lien may add foreclosure remedies to the Creditor's contractual rights. There is no common law right to file any Mechanic's Lien in New York, so all Mechanic's Liens depend upon rights arising from the Lien Law Statute. As such, all procedural Lien Law requirements must be followed before an enforceable Mechanic's Lien is created.

In most instances a Creditor interested in filing a Mechanic's Lien against an oil & gas well is looking to the subject real property for security. In New York the definition of "real property" in the Lien Law includes: *all oil or gas wells and structures and fixtures connected therewith, and any lease of oil lands or other right to operate for the production of oil or gas upon such lands...*" (Lien Law § 2(2)). However not all real property is subject to the traditional Mechanic's Lien. Property belonging to the State or a public corporation is not subject to a Mechanic's Lien, although related remedies are available. Remedies will be covered below; but for the purpose of this introduction, keep in mind that a Creditor must first figure out whether the property is privately or publically owned before the appropriate lien can be filed.

Cost is naturally a consideration in enforcing or foregoing lien rights. In many cases the cost of filing a Mechanic's Lien increases dramatically if the claim lacks essential information and documentation about the property and the entities involved. Regulations governing the minimum spacing between wells often force a developer to obtain leases from several different property owners. As a result there may be many parcels of real property, property owners, and lessees involved in a just one well. The complexity is multiplied with the number of wells developed at the same time. Suffice to say that a Creditor can greatly reduce the cost associated with filing a Mechanic's Lien by simply requiring adequate documentation from the developer during the course of extending credit. This would include a copy of every Oil & Gas Lease and identification of every entity involved (including each contractor, subcontractor, owner, and bank).

3. Private or Public Lands: Most oil & gas development in New York in the past has taken place on privately owned lands, so most Mechanic's Liens have been filed against the real property. If privately owned land (or land owned by an industrial development agency) is involved, then the Mechanic's Lien is filed against the real property which may include oil & gas wells, structures, and leases. However if the development takes place on public lands, then an entirely different type of lien may be involved; and filing the wrong Mechanic's Lien would be futile. The role of the State or public corporation owner may also affect the type of lien involved. For example, (1) if the well is developed on a farmer's private land, then the lien is against real property and should be effective at least as to the oil & gas wells, structures, and leases; (2) if the well includes part of a State Forest, then a lien against real property may or may not be effective as to the oil & gas wells, structures, and leases if the State does not also serve as developer (although the Statute makes no distinction on this point, so enforceability would be subject to a case-by-case interpretation); (3) last if the State were to act as both developer and owner of the lands, then the State's ownership interest cannot be reached with a Mechanic's Lien against real property, and even the oil & gas wells, leases, and royalties may be beyond reach (subject again to a case-by-case interpretation). In such cases the Creditor may be required to file a Mechanic's Lien on account of public improvement and be limited to the contract funds appropriated for the development. Suffice to say that care is needed in order to acquire or enforce any lien rights relating to publically owned lands. For the balance of this outline, we will assume that the subject wells are situated on privately owned lands.

4. Mechanic's Liens on Real Property: A person or corporation which performs labor or furnishes materials for the improvement of real property with the consent of the owner, his agent, contractor or subcontractor shall have a lien (Lien Law § 3). Materials actually manufactured for a project but not yet delivered are covered. Note that labor and/or materials furnished prior to formation of valid leases, contracts and subcontracts may not be protected by lien rights. Again, require adequate documentation, including copies of signed contracts prior to furnishing labor and/or materials on credit.

5. Extent of Lien: Historically the entire interest of an owner such as a farmer could be subject to lien rights acquired in oil & gas development. Consequently a family farm could be jeopardized by a lien foreclosure. To remedy the problem New York law was changed, and now makes a distinction between a property owner and a developer of oil & gas resources. If the owner, e.g. a farmer, does not act as the developer, then any resulting Mechanic's Lien extends only to the oil & gas wells, structures and leases; and not to his interest in the real property (the farm). But if the owner is also developer, then the lien also extends to the owner's interest in the real property (Lien Law § 4).

6. Contents of Notice of Lien: Notices of Lien must include information on the lienor, contractor, subcontractor, owner, as well as other things described in Lien Law § 9. Forms designed to satisfy the filing requirements are available from legal stationary firms in New York such as David F. Williamson, Inc. of Buffalo ((716) 852-0026) and Julius Blumberg, Inc. of New York City ((800) 529-6278). Law firms serving lien creditors often have their own copyrighted forms.

7. Filing of Notice of Lien: A Notice of Lien against real property may be filed at any time during the work or within eight (8) months after completion of the contract, final performance of the work, or last item of materials furnished (note that different rules apply to public improvements). The time is limited to four (4) months if the real property is improved by a single family dwelling. It may be argued that the presence of a single family farmhouse on the parcel where the well is developed limits the time to four (4) months (subject to a case-by-case interpretation); but the four month rule, designed for residential construction, should not (in the author's view) have application. When in doubt a Creditor would be prudent to file within four months if the real property is also improved by a single family dwelling in order to avoid such arguments.

8. Service of Copy of Notice of Lien: Service of a copy of the Notice of Lien must be made in accordance with Lien Law § 11, and § 11-b. The owner and any contractor and subcontractor must be served with a copy within thirty (30) days after the lien is filed; and proof of service must be filed within thirty-five (35) days after the Notice of Lien is filed, or the Notice of Lien terminates as a lien. While these requirements for filing the Notice of Lien, serving copies, and filing proof of service seem as simple enough, many, many liens are terminated in New York for failure to follow these rules.

9. Priority of Liens: Discussion of Lien Law § 13 which governs the priorities among liens, conveyances, mortgages, judgments, assignments, advances, among other things, is well beyond the scope of this outline. However, some general guidelines may be useful, even though a careful review of this lengthy Statute is needed to determine any particular question of priority. In general terms, Mechanic's Liens are given priority over conveyances, mortgages, and judgments which are not filed until after the Mechanic's Lien is filed, with notable exceptions relating to construction loans. Note that conveyances, mortgages, and judgments filed prior to a Mechanic's Lien may have priority over subsequently filed Mechanic's Liens, so a Mechanic's Lien is unlikely to provide a remedy if the developer has no equity in the development.

As a general rule claims secured by Mechanic's Liens are given parity under the New York Lien Law. Generally valid liens are given the same priority and entitled to share *pro rata* in the funds derived from lien foreclosure. However the time of filing may affect the priority given a particular lien, especially where there are intervening judgments, mortgages, etc. In rare situations the holder of a Mechanic's Lien claim may gain priority over other Mechanic's Lienors by reducing his contractual claim to judgment. However given the time needed to recover judgment this is unlikely to be a concern in the short term.

10. Timely filing of liens: Mechanic's Lien claims against privately owned real property in New York must usually be filed within eight months as noted in Paragraph 7 above. Some Creditors may be tempted to wait until the "last minute" to file a Mechanic's Lien. However this may be a fatal strategy. The Lien Law expressly protects an owner/developer from paying for services and materials more than once, so owner/developer is not usually liable to a lien creditor to the extent of payments made prior to the time when a Mechanic's Lien is filed. Consequently any delay by the lien creditor in filing its Notice of Lien may greatly reduce the enforceable amount of its Mechanic's Lien claim and relegate the Mechanic's Lien creditor to other more costly remedies such as an action to recover Trust Funds; and even a Trust Fund action may not provide an adequate remedy if the contractor and/or subcontractor files bankruptcy.

Of course many oil & gas developments are financed with money from limited partnerships and other entities. Sometimes a developer will assign lease rights and future royalties to the entities providing financing for the development. While such assignments may be perfectly legal and legitimate, they may also cut off some rights of a lien creditor, if the lien creditor waits until after the assignment is filed before filing its Mechanic's Lien. As such any unnecessary delay in filing a Mechanic's Lien may well impair the lien creditor's rights.

11. Duration of Mechanic's Lien: As a general rule a Mechanic's Lien against real property in New York has a duration of one year, but may be extended. Mechanic's Liens are often extended by the filing of an Extension fulfilling the requirements of Lien Law §17, by obtaining a Court Order continuing the Mechanic's Lien, or by foreclosure of the Mechanic's Lien with a filing of a Notice of Pendency.

If a Mechanic's Lien claim cannot be resolved within a year after the Notice of Lien is first filed, then it is often advisable for counsel to file an Extension in accordance with the Statute, thereby extending the Mechanic's Lien for another year after the Extension is filed. Filing must be accomplished prior to expiration of the Notice of Lien (as is true with the other methods of extending a lien), or the Lien is deemed terminated by passage of time; and the New York Courts have not been inclined to revive terminated Mechanic's Liens.

If a Mechanic's Lien claim cannot be settled before the one year Extension expires, and the lien creditor is not prepared to commence a foreclosure action, then the lien creditor may seek to have the Mechanic's Lien extended for another year by Court Order. A Special Proceeding is usually required to obtain the Court Order and New York counsel is needed to appear in Court on behalf of a corporate lien creditor. Filing fees, service of process, and related expenses typically amount to \$300.00 or more plus the cost of legal services. Courts may extend an unexpired Mechanic's Lien for another year, and may extend year after year under the appropriate circumstances.

If a Mechanic's Lien claim cannot be resolved short of a foreclosure action then an unexpired Mechanic's Lien may be extended by the commencement of a foreclosure action and the filing of a Notice of Pendency which extends the lien for three more years. The particulars of foreclosure practice are well beyond the scope of this outline, but in general terms an action may be brought to foreclosure all unexpired Mechanic's Liens arising from the same project. Of course the interest of the developer must be significant enough to justify the cost of a multiparty foreclosure action.

12. Mechanic's Lien Bonds: The filing of a Mechanic's Lien often impedes further development and discourages subsequent construction loan advances. Sometimes this enables the Mechanic's Lien creditor to negotiate a quick settlement of its claim with the developer. However in situations where the developer does not anticipate a fast and favorable resolution of all Mechanic's Lien claims, the developer may prefer to bond off those claims by filing a Mechanic's Lien Bond. Such bonds must be approved by the Court, and once approved and filed serve to replace the real property as security for the Mechanic's Lien claim described in the bond. The process of bonding off a Mechanic's Lien has become routine in New York, but care must still be exercised by a lien creditor to preserve its rights when a bond is filed. When the developer seeks a stipulation as to the bond to be filed, the lien creditor should confirm that the bond amount is adequate, and that the proposed bonding company is authorized to do business in New York. Otherwise the bond may prove to be worthless. After the bond is filed the Mechanic's Lien is still a Mechanic's Lien so the lien should still be continued before it expires by Extension, Court Order, or foreclosure as described above.

13. Bankruptcy Implications: The filing of a bankruptcy case may have a profound effect upon all claims; and the effect will vary, depending upon which entity is the debtor-in-bankruptcy, and depending upon whether the creditor has secured its claim by filing a Mechanic's Lien. While any complete discussion of a creditor's rights in bankruptcy is well beyond the scope of this outline, it is preferable in most cases to have the rights of a secured creditor when pursuing rights against a debtor-in-bankruptcy. In many cases secured creditors may have grounds to lift the *automatic stay* (11 USC § 362) in order to foreclose their lien(s), while unsecured creditors go unpaid. While one cannot safely generalize about the enforceability of any lien without knowing the particulars of the lien and the bankruptcy case, it is probably fair to say that it pays for a creditor to perfect its Mechanic's Lien rights if a bankruptcy is expected.

In cases where the developer has filed bankruptcy, the lien creditor's contractual claim could be discharged by the bankruptcy; but the lien creditor may have grounds to lift the *automatic stay* (11 USC § 362) in order to foreclose its lien. If the *automatic stay* is lifted by an Order of the Bankruptcy Court, then it may be possible for all valid liens to be foreclosed together in one foreclosure action, perhaps even funded by the general contractor or by a cost-sharing arrangement. If the contractor files, then those with claims secured by Mechanic's Liens may well have priority claims to the trust funds which may be payable to the contractor by the developer.

Some creditors jump to the conclusion that all is lost when a bankruptcy case is filed. However a properly perfected Mechanic's Lien claim may not be lost at all, so care must be taken to evaluate rights and remedies after a bankruptcy case is filed, and of course the advise of experienced bankruptcy/lien counsel may prove to be invaluable. If the creditor having lien rights has still not perfected its lien before the bankruptcy case is filed, then is it too late to file the lien? It may seem so; but the leading case on this issue held that a contractor's post-bankruptcy perfection of a Mechanic's Lien was proper and did not violate the *automatic stay* (In re Lionel Corp, 29 F3d 88 (CA2, 1994)). Of course common law standards change over time and pursuing any rights against a debtor-in-bankruptcy carries some risk of violating the *automatic stay*, so the advise of experienced bankruptcy counsel is always advised.

This outline was provided for educational and informational purposes by The Dean Law Firm P.C. of Grand Island, New York, and should not be viewed as furnishing legal advice. Please give us a call if you have any questions or need further information about filing a Mechanic's Lien in New York. Prepared by Robert A. Dean, Esq., The Dean Law Firm P.C., 1870 Whitehaven Road, P.O. Box 1005, Grand Island, New York 14072, phone: (716) 773-3740, fax: (716) 773-3723, or email: deanlaw@buffnet.net.