

Nicholas Stern



Don't Mess with Texas' Mechanic's Lien Law: Proposed Bill Would Be Net Negative for Suppliers

Texas mechanic's liens are not easy. Following the process to secure payment on a job can lead to multiple steps that must be strictly followed. Notice filing deadlines can be confusing, particularly for the novice. For example, notices for commercial projects have to be sent to the owner and prime contractor no later than the 15th day of the third calendar month following each month in which materials or services were furnished.

"Texas lien law is commonly known as having some of the most onerous requirements in the country to perfect a lien on real property," said Jason Walker, Esq., shareholder and director of litigation at Andrew Myers in Houston. One reason for this is that, historically, Texas has always been a strong property rights state, and the law reflects the deep respect the state has for property owners.

Generally, the current law has worked well to secure the payment rights of material suppliers and subcontractors, noted Randall Lindley, Esq., partner with Bell Nunnally in Dallas. "It requires a lot of effort on a monthly basis, but they're usually very happy with the results they get," he said. That's why he and other professionals who represent or advocate for suppliers and subcontractors are not pleased with the current bills in the Texas House of Representatives (HB 3065) and State Senate (SB 1506).

The bills would essentially upend the current law and replace it with one that seems to favor general contractors (GCs) over other parties to construction projects by removing the notice letter requirements sent to both GCs and owners. "These notice letters have the practical effect of making money flow down the chain," Lindley said. "GCs as a group do not like it when their subs and suppliers report to owners their failure to pay." (To pass this year, the bill would need to be approved in the legislature by May 29. If made into law, it would become effective next year.)

Kathleen Quill, CBA, CAE, and president of NACM Gulf States, said that while Texas' law could be made easier to use—one of the factors many like about the bill is its mandate of an electronic filing system—supplier members are not supportive on balance and don't like the fact that it would take away fund trapping as a leverage to get paid. Statutory retainage will also be taken out of the statute. And while she's seen efforts in

the Texas legislature to introduce a new mechanic's lien bill come and go over the past 20 years, the effort to pass this one—the House and Senate bills are essentially the same—has never been more organized, particularly without the support of supplier input.

The bill would also "result in more liens getting filed, because the pressure won't be on upstream parties to make sure suppliers get paid timely," said Walker. "Certainly there are things about the current lien statute that can be changed and modernized, but this is a throwing the baby out with the bathwater approach," he said.

The Important Proposed Changes

A major difference the proposed law would inculcate is changing Texas to a preliminary notice state; current law is geared toward a past due or debt notice system, Walker said. That means that suppliers and others would no longer have to understand or handle the issues of statutory retainage, fund trapping, accrual of indebtedness, special notices of contractual retainage/special fabrication and calculating most of the timelines to send notices.

Statutory retainage. Current Texas lien law can confuse construction creditors as to when to notice for funds withheld on projects related to Texas' retainage of 10% of the contract amount until the project is completed. The proposed law would do away with such confusion as retainage would no longer be required by statute, he said. However, specific contracts could still reintroduce the concept of retainage, so the new law doesn't eliminate the possibility going forward.

Fund trapping. Texas' current system of noticing owners, which serves as a fund-trapping mechanism, is essentially based on debt; if a supplier hasn't been paid timely, it will send notices based on the owed amount, Walker said. The system works so that, usually, suppliers and others send these notices much more frequently than they file actual liens. The proposed law would change Texas into a preliminary notice state, meaning suppliers and subcontractors would have to send a notice of furnishing to the owner and original contractor(s).

Notices of furnishing. According to the proposed bill, a single notice of furnishing would preserve lien rights as long as all original contractors are listed, unlike the current system in which multiple notices have to be sent for

each month in which services are rendered or materials are furnished in order to perfect lien rights. This change could become burdensome particularly for suppliers and other smaller firms that may have hundreds or thousands of little jobs that would need to be noticed when, under the current statute, only a small fraction do, Quill said. The proposed notices of furnishing—which could be filed electronically on the lien website through a form provided by the Secretary of State—would provide a “look back” period of 45 days; or, preserve a right to lien for labor performed or material furnished for 45 days before the notice is filed, Walker said. However, if the owner instead files a notice of commencement (filed with the county clerk and posted on the lien website) and appoints a lien agent at the time of first furnishing, the look back period of the notice of furnishing is reduced to 15 days. “I think [the latter 15-day provision] is going to have some unintended consequences,” Walker said, such as generating confusion by creating a dual time period that needs to be closely monitored.

Notice of commencement. New to the lien system proposed in the bill, the notice of commencement for owners would have to be filed with the county clerk and posted on the lien website. This optional notice would reduce the look back period for furnishing notices, allow owners to require a conditional waiver and release from a claimant and allow owners to file a notice of termination on the lien website rather than send notices out to all claimants, Walker said.

The proposed lien law would generate a new level of bureaucracy to handle some portions of the filing process. Those owners wishing to file a notice of commencement, for instance, must appoint and identify a lien agent, who must hold a Certificate of Registration from the Texas Department of Insurance (TDI), he said. Lien agents would be tasked with creating and maintaining the filing website. Fees for lien agents would be charged to owners and initially be set by statute, with later review and regulation carried out by the TDI. “It appears this will shift more of the risk of nonpayment from the GC to the owner,” Walker said.

Lien affidavits. Affidavits are currently needed to file for the actual lien and, according to the proposed law, *would still need to be recorded* with a county clerk on the 15th day of the fourth month after the completion of the original contract for commercial projects and the 15th day of the third month after the completion of the original contract for residential projects, he said. After project completion, the owner would be able to send a written demand for a claimant to file a lien affidavit within 30 days.

Differences between public and private projects. Liens in Texas only pertain to private projects, while public projects are governed by the Texas Government Code, Walker said. The latter is an entirely different statute, though it has some similarities with the current lien law, for example, in terms of noticing requirements. The proposed law would do nothing to change the public project statute and would introduce even more differences between the two sets of laws. ■

Nicholas Stern, senior editor, can be reached at nicks@nacm.org.

TEXAS LIEN LAW BEST PRACTICES

Texas’ mechanic’s lien law is one of the most cumbersome in the nation; construction creditors need to be diligent in following its various provisions to successfully perfect and realize their rights to payment on the job. The staff of NACM’s Secured Transaction Services—including Connie Baker, CBA, director of operations; Susan Riley, CBA, assistant director; and Carol Davis, legal placement assistant—advise countless material suppliers, subcontractors and other construction entities each day on how to properly comply with the law. Below, Baker, Riley and Davis lay out a few of the common errors they encounter and recommend some best practices construction creditors should follow to secure payment under the law.

Make sure you know who you sold to. This will help construction creditors determine which notices to send and when. If you’re contracting with the prime contractor, serve the notice to the owner and prime contractor no later than the 15th day of the third calendar month following each month in which material or services were furnished.

If you’ve contracted with remote contractors and suppliers, serve the prime contractor no later than the 15th day of the second month following each month in which all or part of the material was delivered or the labor was performed. Serve the owner and prime contractor no later than the 15th day of the third month following each month in which all or part of the labor was performed or the material was delivered.

Public projects will require additional parties to be notified—such as a surety company—along with a sworn statement when serving the third month, 15th-day notice. A sworn statement is different than an account statement, which reflects an account balance, and is required within the third-month notice. It is crucial for trade creditors in this situation to obtain a copy of the payment bond to learn the required information about the surety party. Another potential mistake construction creditors might make is sending notices based on invoice dates, instead of properly using furnishing or labor performance dates.

Don’t wait too long to send fund-trapping notices. Trade creditors should send out notices *before* an owner to a private construction project pays the GC or other contractors higher on the payment chain. Hesitating to send notices too close to the deadline, and having an owner pay his or her GC, could mean that a supplier can then only lien on project funds tied up in retainage. In Texas, the statute calls for retainage of 10% of the contract amount until the project is completed.

File the lien affidavit in a timely manner. For ordinary progress billings, the lien affidavit has to be recorded no later than the 15th day of the fourth calendar month after the date on which the claimant completes its work or furnishings. A lien cannot be perfected if a copy of the lien affidavit is not sent to the owner. This deadline is *not* based on when the entire project is completed, unless the lien claimant is the original contractor. (Note that residential lien affidavit filing is different and requires the lien to be filed the third month, 15th day.)