

SUBJECT: Residential construction contract liens

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 9 ayes — Brimer, Rhodes, Corte, Dukes, Elkins, Giddings, Janek,
Solomons, Woolley

0 nays

0 absent

WITNESSES: *(On original version):*
For — Gary Sheffield, Texas Association of Builders

Against — Linda Bost, Gulf Coast Concrete; Joseph Chiavone; Hugh Cliett;
Barbara Douglass, Lumbermen's Association of Texas; John Heasley, Texas
Banker's Association; Brenda Kato, Redi-Mix, Inc.; David Pinkus, Small
Business United of Texas; Raymond Risk, American Subcontractors
Association of Texas; Jim Sewell, Association of General Contractors;
Robert Sneed, Texas Land Title Association; Mike Stewart

On — None

BACKGROUND : Contractors, subcontractors, and suppliers secure credit through the issuance of mechanics' and materialmen's liens. Such liens use the property being improved as collateral for payment on the construction contracts. Chapter 53 of the Property Code establishes who is entitled to a lien, procedures for perfecting such a lien, and what actions may be taken after such a lien is perfected. If a contractor, subcontractor or supplier of labor or materials used in the construction, repair or improvement of real property is not paid, a lien may be executed. If notice requirements for such liens are met and the debt is not paid, the property subject to the lien may be foreclosed.

DIGEST: CSHB 740 would establish additional procedures for mechanics' and materialmen's liens concerning residential construction projects. It would repeal the current section setting out procedures for perfecting a lien against property that is a homestead, moving that section to a new subchapter concerning residential construction projects.

Residence would be defined as a single-family house, duplex, triplex or quadruplex used or intended to be used for residential purposes by one of the owners. All contracts to construct, repair or improve a residence would be required to follow the proposed new provisions as well as all current requirements in order to execute a lien on residential property.

Residential construction contracts

Homestead Improvements. A written contract would have to be executed by the person who was to furnish material or perform labor in order to fix a lien on a homestead. As under current law, the contract would have to be executed before performance or delivery, both spouses would have to sign the contract, and the contract would have to be filed with the county clerk of the county in which the property was located.

Disclosure statement. CSHB 740 would require the contract to include a written disclosure statement substantially similar to language contained in the bill. The proposed disclosure statement would include the following sections:

- know your rights and responsibilities under the law;
- know your contractor;
- get it in writing;
- read before you sign;
- get a list of subcontractors and supplies;
- monitor the work;
- monitor payments;
- claims by subcontractors and suppliers;
- some claims may not be valid;
- obtain a lien release and a bills-paid affidavit, and
- obtain title insurance protection.

List of subcontractors and suppliers. CSHB 740 would require the original contractor to a homestead construction or improvement contract to also submit to the owner a list identifying each subcontractor and supplier, giving names, addresses and telephone numbers. Any additions or corrections to the list would have to be supplied to the owner within 15 days of the change.

Loan Information. If an owner obtained third-party financing for improvements to a homestead, CSHB 740 would require the lender, except in cases of a bona fide emergency, to deliver all information regarding the loan to the owner at least one day before the date of closing.

Disbursement of funds. CSHB 740 would require the original contractor to provide the owner with periodic statements of funds disbursed by the contractor to subcontractors and suppliers. If the owner financed the construction of improvements so that a third-party lender paid the contractor directly, the lender would be required to obtain from the contractor the periodic list of payments for which the contractor was requesting reimbursement. The lender would have to provide the owner with a statement of funds disbursed. If a person intentionally, knowingly or recklessly provided false or misleading information regarding the disbursement statements required, the person could be subject to a maximum criminal penalty of a fine of up to \$4,000 and confinement in jail for up to one year. A person convicted of such a crime would be ineligible for community supervision (probation).

Final Bills-Paid Affidavit. In order for an original contractor to receive a final payment, CSHB 740 would require the contractor to deliver to the owner an affidavit stating that all subcontractors and suppliers had been paid in full. If all subcontractors and suppliers had not been paid in full, the original contractor would have to state in the affidavit the amount owed and identify to whom it was owed. If an owner sold a piece of property with no more than four dwelling units that the buyer intended to become his principal residence, the seller would have to deliver an affidavit stating that the seller had paid each person in full for all labor and materials used in the construction of improvement to the property or showing any debt owed by that owner and to whom it was owed. If a person intentionally, knowingly or recklessly provided false or misleading information regarding such final payment statements, the person could be subject to a maximum criminal penalty of a fine of up to \$4,000 and confinement in jail for up to one year. A person convicted of such a crime would be ineligible for community supervision (probation). A person signing such an affidavit would also be liable for loss or damage arising from the false or incorrect information in the affidavit.

Failure by the contractor to comply with sections regarding the disclosure statement on the contract, the disclosure of all subcontractors and suppliers, the notice from third-party lenders, or disbursement of funds would not invalidate a lien.

Notice to owner and original contractor. CSHB 740 would require a subcontractor to give notice to the owner of property on which the subcontractor could file a lien no later than two months after the labor was performed or material was delivered that was the basis for the lien. (Current law requires such notice within three months after performance or delivery.)

Liens on residential property. A person claiming a lien on residential property arising from a residential construction contract would be required to file an affidavit with the county clerk of the county in which the property was located no later than the 15th day of the third month after the day the indebtedness accrued. (Current law allows four months.) CSHB 740 would increase the specificity needed in the affidavit, adding requirements to list the last known addresses of persons affected, a statement for each month of work performed and material furnished, and a statement identifying the dates of notices required and how notices were sent. CSHB 740 would require a person who filed an affidavit to send a copy of it by registered or certified mail no later than one business day after the affidavit was filed. (Current law allows a copy to be sent within 10 days of filing.)

Funds withheld by owner. If an owner withheld funds, as allowed under current law, the affidavit the owner is currently required to file could, under CSHB 740, also include:

- a waiver or release of lien rights conditioned on receipt of actual payment or collection of funds;
- a warranty that certain bills or classes of bills would be paid by the affiant from funds to be paid, and
- an indemnification by the affiant for any loss or expense resulting from false or incorrect information.

If a person intentionally, knowingly or recklessly provided false or misleading information regarding an affidavit required for the owner to withhold payment, the person could be subject to a maximum criminal

penalty of a fine of up to \$4,000 and confinement in jail for up to one year. A person convicted of such a crime would be ineligible for community supervision (probation). A person signing such an affidavit would also be liable for losses or damage arising from the false or incorrect information in the affidavit.

Suits to foreclose a lien. A suit to foreclose a lien arising from a residential construction contract would have to be filed within one year after the lien affidavit was filed. (Current law allows two years after the affidavit is filed.)

Summary motion to remove invalid or unenforceable liens

In a suit brought to foreclose a lien, a party would be allowed to file a motion objecting to the validity of the lien. If such a motion was granted, the lien would be removed.

A lien could only be held invalid or unenforceable for the following reasons:

- notice of the claim or filing of the affidavit was not furnished to the owner or original contractor;
- the affidavit claiming the lien failed to comply with the requirements set out in statute or was not filed in the time required;
- the owner paid the amount due to the original contractor before the lien was perfected or before the owner received notice of the claim;
- funds subject to the claim had been deposited in the registry of the court and the owner had no additional liability;
- for liens filed on homestead property, there was no contract executed or the affidavit failed to contain the required notice or statement, or,
- the claimant executed a valid waiver or release of the claim or lien.

At a hearing held on such a motion, the burden would be on the movant to establish grounds authorizing removal of the lien. The claimant would be required to prove that the notice of claim and affidavit of lien were furnished to the owner and original contractor as provided by law.

The court, in the order removing a lien, would have to provide an amount required to stay the removal of the lien. The amount would be the reasonable estimate of the costs and attorney's fees the person wishing to

remove the lien would be likely to incur in the proceeding to determine the validity or enforceability of the lien. The amount could not exceed the amount of the lien claim. An order removing a lien could be stayed if the claimant filed a bond, or deposit in lieu of a bond, in an amount set by the court. If the court failed to set an amount, the bond required would be the amount of the lien. The claimant would have to file the bond within 30 days of the court order removing the lien unless the court allowed additional time for good cause.

If the lien claimant failed to file the bond required, the owner or original contractor would be allowed to file with the county clerk the lien removal order and a certified copy from the clerk stating that no bond had been filed or no order staying the order to remove the lien had been filed. Such a filing with the county clerk would remove the lien claim or lien as to any creditor or subsequent purchaser, but the removal of the lien would not release the owner from any other liability owed to the lien claimant.

If the claimant received a final judgment in a suit that established the validity and enforceability of the claim after an order removing the lien was filed, that final judgment would revive the lien and allow the claimant to foreclose on the lien. However, the revived lien would be invalid to a creditor or subsequent purchaser who obtained an interest in the property after the order removing the lien was filed with the county clerk and before the final judgment reviving the lien was filed with the county clerk.

Bond to indemnify against a lien. A mechanics' or materialmen's lien claim would be discharged against the owner's property if the owner filed a bond indemnifying against a lien and filed notice of such a bond as required by current law. (Under current law, such a bond must be twice the total of the amounts claimed in all liens against that property if that amount is less than \$40,000, or 1.5 times the amount claimed in the liens if that amount is over \$40,000, and notice must be given to all obligees.) CSHB 740 would modify the notice requirement for bonds to indemnify against a lien to require notice to be given by certified mail to any claimant who included the claimant's address in the affidavit of a claim.

CSHB 740 would take effect on September 1, 1997, and apply to claims arising out of contracts entered into on or after that date.

SUPPORTERS
SAY:

The House Committee on Business and Industry conducted an interim study on issues related to residential construction contract liens after the 74th legislative session. The committee's report on that issue recommended substantial changes to both commercial and residential lien laws, including creating a separate section for residential construction contracts, increasing penalties for filing false or invalid liens, reducing the time period for filing residential lien claims, establishing consumer disclosures and loan documentation on all residential construction contracts, and numerous other changes. Most of the committee's interim recommendations relating to residential construction contracts are included in CSHB 740.

The committee found that the most prevalent problem regarding mechanics' and materialmen's liens on residential property is that the owner of the property was not made aware of what such liens were and how they could be prevented. The notice that was given to owners was not sufficient to warn them of the dangers of having such liens filed against them, and when notice was given, it was not done quickly enough. CSHB 740 would remedy many of these problems by adding requirements for disclosure and notice to residential construction contracts. The disclosure statements added would let the owner know in plain language what rights were available under the law. By increasing the notice requirements and speeding up all such requirements, owners will be able to follow what is happening to them and find ways to prevent it.

The purpose of this legislation is not to overburden contractors with lengthy forms or stringent requirements, but to simply give homeowners the tools they need to deal with the pitfalls of lien law. In order to provide property owners with such tools, every party involved in construction contracts, from general contractors to suppliers to lenders, would have increased requirements. In this way, the burden for providing information to consumers would be spread evenly, and no one party would have to bear the risks.

The most important change in the notice requirements concerns sending notice to the property owner within one day of filing an affidavit for a lien. Under current law, that time period is 10 days, and the person who files an affidavit often forget to send notice immediately because he has 10 days to do so. The normal rule for prudent lien claimant is to send notice to the

owner when the affidavit is filed; otherwise, there is a chance the claimant would forget. By shortening the notice requirement, CSHB 740 would ensure that notice will be sent as soon as the affidavit is filed.

The final bills paid affidavit that would be required by CSHB 740 would be another important tool for consumers. It would help to protect both the property owner and future purchasers and creditors when the owner believed that all bills had been paid for a construction project or improvement. In many cases, after a project is completed, the property may be sold. If it is sold, it is very difficult for the subsequent purchaser to receive notice of a lien claim. The final bills paid affidavit would allow subsequent purchasers to ensure that the property passed to them was unencumbered with possible mechanics' lien claims.

The proposed summary motion would also be important in quickly disposing of lien claims. In many cases, the lien is paid off as soon as a case is brought, yet the property is still encumbered until the suit is finally disposed of. The summary motion would allow claims that were invalid or already paid to be disposed of quickly without limiting the rights of the claimant to stay the removal of the lien or obtain a final judgment on the lien.

CSHB 740 would strengthen criminal penalties for filing false claims. During interim hearing a substantial amount of testimony was given concerning false claims filed by contractors prompting lien claims. Criminal penalties would only be available if a person intentionally, knowingly or reckless submitted a false statement, but eliminating the option of probation would ensure that the person would be punished for such actions, not simply given a slap on the wrist.

This legislation is no different from other legislation in its effective date. With any new law, there is a short time for changing required forms and educating people about the law, but the importance of this legislation requires the change to be made in the normal time period for all other legislation.

OPPONENTS
SAY:

CSHB 740 would significantly add to the burdens of lien claimants. Public policy should dictate that lien laws be construed liberally in favor of the claimant. It is the lien claimant who has done work or provided materials and not received payment. Complicated requirements in lien laws would unduly burden these businesses. Small contractors and suppliers would have the most difficulty complying with the requirements of the law.

Moving the date requiring notice of an affidavit to be mailed to the owner of the property from 10 days to one day would be unreasonable. If the current 10-day period is too long, it should be reduced to no less than five days. A one-day requirement would not allow for unforeseen delays caused by conditions outside of the claimant's control.

The criminal penalties included in CSHB 740 are inappropriately harsh. While the actual penalty for filing false statements is still a class A misdemeanor, the bill would specifically prohibit a person convicted of such a crime from receiving probation. Probation is a discretionary punishment, the use of which is left to the judge to apply to the facts of the case. By prohibiting the use of probation, a judge could be forced to impose jail time on a contractor who recklessly filed a false claim.

The effective date of CSHB 740 would be too soon for most construction companies, title companies, lenders and construction equipment suppliers to be educated about the new requirements and change their forms to comply. The effective date should be moved to at least January 1, 1998, to allow these businesses the chance to understand and correctly follow the law.

NOTES:

The committee substitute deleted provisions in the original version of the bill concerning prompt payment of subcontractor or supplier claims, residential construction claims based on tract or speculative homebuilding, and construction trust funds.

A related bill, SB 241 by West, would require contractors to act as trustees of monies paid to them by the property owner to pay labor and materials costs from subcontractors and suppliers. Any contractor who contracts to make improvements to residential property costing more than \$5,000 would be required to establish a construction account for payments to

subcontractors and suppliers. SB 241 passed the Senate on March 5 and has been reported favorably by the House Business and Industry Committee.