

MECHANIC'S LIEN

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When it comes to construction, real-estate professionals know that there are three axioms we can always count on: it will cost too much, take too long, and never quite turn out the way you wanted. If you've ever had to deal with mechanic's or materialmen's liens on your commercial properties, I am sure you will acknowledge that these axioms are true and correct. Construction-lien claims can arise out of work initiated by the owner of the real property and **Background:**

Texas construction-lien laws are some of the most complex (and confusing) lien laws in the country. In Texas, liens for work performed, materials or equipment (known as "mechanic's and materialmen's" liens) are governed by both the Texas Property Code and the Texas Constitution. Specifically, Texas Property Code Section 53 creates statutory mechanic's liens that must be properly and timely perfected. **To perfect a lien, a contractor or supplier must timely send written notice and record a lien affidavit. An original contractor (i.e., one who has a direct contract with the owner or its agent) may secure a constitutional lien without satisfying the notice or recording requirements.**

The lien statute in the Property Code tries to accomplish two things. First, it requires property owners and tenants to take reasonable steps to ensure that its contractors are paying their subcontractors and vendors. Second, it provides subcontractors and vendors who have an oral or written contract with the general contractor protection for the work or materials provided. However, if the subcontractor fails to timely comply with the procedures in the Property Code, their lien may be invalid from work your tenants perform. **If either the property owner or the tenant fails to pay the general contractor, or the general contractor fails to pay its subcontractors or suppliers, then liens can be filed against the property and the tenant's leasehold interest.**

"The only way you will ever permanently take control of your financial life is to dig deep and fix the root problem."

- Suze Orman

Liens for Retainage:

Section 53.101 of the Property Code requires the owner or tenant to withhold 10% of the contract price of the work or 10% of the value of the work as a "statutory retainage". This retainage must occur for each payment during the project and for thirty (30) days after completion. The retained funds are to secure payment for subcontractors and suppliers. If you fail to hold the 10% retainage, a subcontractor or supplier can have a lien against the property, at least to the extent of the amount that should have been retained. If a subcontractor or supplier was engaged by your tenant's general contractor, they should only be allowed to file a lien against the tenant's leasehold interest (and their leasehold improvements). However, oftentimes a tenant's subcontractor attempts to create leverage by filing a lien against the owner's property.

Liens Against "Trapped Funds":

In addition to the statutory retainage, the owner or tenant can have additional liability depending upon whether funds were "trapped" by proper fund trapping notices. This is in addition to the statutory retainage discussed above. If, during a construction project, a subcontractor or supplier is not paid, they can send written notice to the owner, and upon timely receipt of a proper notice, the owner must "trap" any funds from being paid to the contractor. A subcontractor or supplier can obtain a lien on the property or the tenant's leasehold improvements (as the case may be), and the property owner or tenant will have personal liability to the extent they received the notice and failed to withhold any further payments.

Deadlines to File Notices for Retainage and Fund Trapping Liens:

For subcontractors and suppliers to take advantage of their lien rights, they must timely and properly send written notice to the contractor and the owner, as well as timely file a proper lien affidavit. The Texas Property Code has strict guidelines for when to send notices and file the affidavits, as well as the content thereof.

Before filing a lien affidavit, a subcontractor must send timely written notice of its unpaid claim to the original contractor not later than the fifteenth (15th) day of the second (2nd) month following each month in which all or part of the claimant's labor was performed or its material delivered. In addition, the subcontractor must also send timely notice of its unpaid claim to both the original contractor and the owner (or tenant) not later than the fifteenth (15th) day of the third (3rd) month following each month in which all or part of the labor was performed, or material delivered. The notices must be sent by registered or certified mail and must be addressed to the owner (or tenant) or the original contractor, as applicable, at their last known business or residence address.

The deadline for a subcontractor or supplier to file a lien affidavit is the fifteenth (15th) day of the fourth (4th) calendar month following the day the indebtedness accrues. The lien affidavit must be filed with the county clerk of the county where the project is located.

The lien affidavit must be signed by the person claiming the lien and contain several facts required by the Property Code, including the amount of the claim. The lien affidavit must be sworn to and notarized. Among the other facts that must be listed in the affidavit, subcontractors must list each month the work was performed and materials furnished. The claimant must send a copy of the lien affidavit by registered or certified mail to the owner (or tenant) not later than the fifth (5th) day after the date the lien affidavit is filed with the county clerk. If a claimant has properly filed his claim, he has two years (one for a residential construction project) to file suit to foreclose his lien.

Failure to adhere to these requirements may invalidate the liens. To that end, if you receive any lien notices or affidavits, you should check with legal counsel to ensure that they are properly prepared and timely sent.

Constitutional Lien for General Contractors:

In addition to the specific procedure outlined above in the Texas Property Code for claiming a lien against the 10% retainage and "trapped funds", **the Texas Constitution provides an automatic lien for improvements to property made by an original contractor who signs a construction contract with an owner or tenant.** A constitutional lien exists without the contractor having to file a lien affidavit, however, the constitutional lien is limited and sometimes the original contractor might want to also file a statutory lien. For example, a constitutional lien cannot be enforced against a "good faith" purchaser of the property who had no knowledge of the constitutional lien claim. Accordingly, contractors should file the lien affidavit anyway to put prospective purchasers of the property on notice of the lien. The constitutional lien is a "last ditch effort" for contractors that forget to timely file their liens or who file an invalid lien.

Certain types of construction work which may be covered by the statutory lien are not covered by a constitutional lien. The constitutional lien is only valid for articles or buildings and the land necessary to its enjoyment. Suppliers of certain materials or equipment that are not "incorporated" into the construction job may not acquire a constitutional lien, even if they are ordered directly by the owner.

Liens on Homestead:

There are additional requirements to obtain a lien on a homestead. These additional requirements must be met prior to performing work on the homestead. A person who performs work or provides material to the homestead owner must sign a written contract with the owner(s). The contract must be executed before the work starts, it must be signed by all owners, and the contract must be filed with the clerk of the county where the homestead is located. There is no deadline to file the contract, but it should be filed before commencing work. To properly file a contract, it will have to satisfy the county's recording requirements – similar to filing a lien. Further, the affidavit of lien must contain the following notice, in a size equal to at least 10-point boldface or the computer

equivalent, at the top of the page: “NOTICE: THIS IS NOT A LIEN. THIS IS ONLY AN AFFIDAVIT CLAIMING A LIEN.”

Texas Property Code Section 53.254 contains additional language that must also be in the lien affidavit, which is above and beyond the required provisions for a commercial (or non-homestead property). This information is too lengthy to list here.

Terminating Invalid or Fraudulent Liens:

Property Code Section 53.157 list six ways to terminate a lien. **The best method is to file a release, which must be signed by the lien claimant.** Most of the methods in the Code require the property owner to file a bond. The bond must be issued by a bonding company, in an amount no less than the amount of the lien. Note that most bond companies will require the owner to supply collateral to back up the lien or sign a guaranty (or both). Also, if the lien claimant does not foreclose on the lien within two years (one for a residential construction project), then the lien can also be removed.

Subchapter J of the Texas Government Code provides three options for the property owner to remove a fraudulent lien. The first is if the court clerk or county clerk is provided with information (usually in the form of an affidavit with supporting documentation) showing a “reasonable basis” for believing that a filed document is fraudulent. In that case, Section 51.901(f) of the Government Code requires the clerk to take steps to try and get the lien removed, including requesting assistance from the district attorney and obtaining additional documentation from the claimant. Second, the property owner may file a verified motion with the district clerk asking for removal of the lien. Section 51.902 of the Texas Government Code contains a form of the verified motion. If the motion is successful, a district judge will rule that the lien affidavit at issue is not a lien. Likewise, Section 51.903 of the Government Code permits the filing of a verified motion to removal a fraudulent lien. This section also applies to fraudulent deeds, and it contains a form of the motion to be filed with the district court.

Once you have removed a fraudulent lien, you can then seek penalties against the person who filed it. Chapter 12 of the Civil Practice & Remedies Code states that a person who knowingly and intentionally files a fraudulent lien may be held liable in civil district court for the greater of \$10,000 or your damages and attorney’s fees. It is also a crime per Texas Penal Code § 37.01. Additionally, the Deceptive Trade Practices Act may give the property owner the legal ability to seek further damages against someone who files a fraudulent lien.

Whether you are a property owner or a vendor, the Texas lien laws are complex – anyone involved in this process needs to proceed with caution to protect your interests.