

SUBJECT: Revising retainage notice under construction contracts

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 7 ayes — Deshotel, Orr, Bohac, Garza, Giddings, Quintanilla, Solomons
0 nays
2 absent — S. Miller, Workman

WITNESSES: For — Elisa Fox, Cummings Electrical, Inc.; Todd Hewitt, Texas Fifth Wall Roofing Systems, Inc.; Dennis Lewis, Potter Concrete, Ltd.; Kenneth Loper, TAS Commercial Concrete Construction, LLC; Richard Thomas, Texas Construction Association; (*Registered, but did not testify:* Barbara Douglas, Lumbermen’s Association of Texas; Jon Fisher, Associated Builders and Contractors of Texas)

Against — Gardner Pate, Texas Building Owners and Managers Association; (*Registered, but did not testify:* Tara Snowden, Zachry Construction Corp.; Corbin Van Arsdale, Associated General Contractors of America Texas Building Branch)

On — Aaron Day, Texas Land Title Association; John Fleming, Texas Mortgage Bankers; Manuel Muñoz, Texas Association of Builders

BACKGROUND: Contractors, subcontractors, and suppliers secure credit through mechanics’ and materialmen’s liens, which use property as collateral for payment on construction contracts. Property Code, ch. 53 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.

Retainage refers to a percentage of the contract price or value of the work in a construction project held by the owner. Sec. 53.101 provides that during the work under an original contract for which a mechanic’s lien

may be claimed and for 30 days after the work is completed, the owner shall retain:

- 10 percent of the contract price of the work to the owner; or
- 10 percent of the value of the work, measured by the proportion that the finished work bears to the work yet to be finished, using the contract price or, if there is no contract price, using the reasonable value of the completed work.

Sec. 53.103 says a claimant has a lien on the retained funds if the claimant sends proper notices and files an affidavit claiming a lien no later than the 30th day after the earlier of the date the work is completed, terminated, or abandoned.

DIGEST:

CSHB 1390 would amend several provisions of Property Code, ch. 53.

Notice to owner of retainage claim. The bill would amend the requirements for a retainage claimant to give notice to the owner. First, the bill would amend the notice deadline. Under current law, the claimant must give the owner notice of the retainage agreement no later than the 15th day of the second month following the delivery of materials or the performance of labor by the claimant. Under the bill, the claimant would be required to give notice that he or she may have a lien claim for retainage to the owner no later than the earliest of:

- the 15th day of the second month following the date the claimant completed the work required under the claimant's contract with the original contractor or subcontractor;
- the 25th day after the date the work under the original contract was completed, provided that the owner, if required, gave notice of completion;
- the 25th day after the date the original contract was terminated, provided that the owner, if required, gave notice of termination; or
- the 25th day after the date the original contractor abandoned performance under the original contract, provided that the owner, if required, gave notice of abandonment.

If a claimant followed the procedures above, the claimant would not be required to give any other notice of the retainage before notice of an affidavit claiming the lien had to be sent to the owner under sec. 53.055.

If the claimant followed the procedures above, the owner could withhold funds immediately on receipt of the notice. Current law states that the owner may withhold funds immediately on receipt of a claimant's affidavit.

The bill would specify that a claimant could give notice for the portion of a retainage claim not exceeding the 10 percent required under sec. 53.101.

Retainage lien affidavit filing deadline. Current law states that a claimant has a lien on the retained funds if notice requirements are met and the claimant files an affidavit claiming a lien no later than the 30th day after the work is completed, the contract is terminated, or the general contractor abandons performance, whichever is earlier. The bill would change the affidavit filing deadline to no later than the earlier of:

- the 60th day after the earliest of:
 - the date the work under the original contract was completed, provided that the owner, if required, gave notice of completion;
 - the date the original contract was terminated, provided the owner, if required, gave notice of termination; or
 - the date the original contractor abandoned performance under the original contract, provided that the owner, if required, gave notice of abandonment; or
- the 15th day of the fourth calendar month after the day when indebtedness accrued, or for residential projects, the 15th day of the third calendar month after the day when indebtedness accrued.

Owner's notice of completion. The bill would require the owner to send a notice of completion to the original contractor and any person providing notice of a retainage claim, including anyone who furnished labor or requested a copy. This notice would have to be sent five days after the date of completion and would be prima facie evidence of completion. The notice would have to contain:

- the name and address of the owner;
- the name and address of the original contractor;
- a description of the real property;
- a description of the improvements;
- a statement that the improvements have been completed; and
- the date of completion.

If the owner did not send notice of completion, then the claimant would not have to comply with retainage claim notice requirements. If an owner sent an affidavit of completion, notice of completion would not be required.

Date contract executed. The bill would require an owner to provide the date the original contract was executed to anyone who furnished labor or materials, if requested in writing. If a subcontractor did not receive this information within 10 days, the subcontractor would not have to comply with retainage claim notice requirements. An original contractor would be required to provide the date the original contract was executed to anyone who furnished work, if requested in writing.

When retainage claim accrues. The bill would clarify that a claim for retainage would accrue on the last day of the month in which all work under the contract was terminated. Current law states that a retainage claim accrues when work is completed, finally settled, or abandoned.

Owner's affidavit of completion. Under current law, an owner may file an affidavit of completion indicating that the improvements have been completed. The bill would require that the affidavit contain a conspicuous statement that the claimant may not have a retainage lien unless the claimant complied with retainage claim notice requirements to the owner under specified deadlines and filed an affidavit claiming a lien no later than the 60th day after the date the work under the original contract was completed.

The bill also would change the owner's deadline for sending a copy of the affidavit to retainage claimants from the date the affidavit was filed or 10 days after receiving notice of a retainage claim, whichever was later, to the date the affidavit was filed or five days after the owner received notice of a retainage claim, whichever was later.

Owner's notice of termination or abandonment. The bill would require the owner to give notice of termination or abandonment of the project in five days rather than 10 days, and would require a conspicuous statement that the claimant may not have a retainage lien unless the claimant complied with notice requirements to the owner and filed an affidavit claiming a lien no later than the 60th day after the date of termination or abandonment. If the owner did not send notice of termination or

abandonment, a subcontractor would not have to comply with retainage claim notice requirements.

Validity of lien. The bill would amend the grounds for objecting to the validity or enforceability of a claim or lien. The bill would require that the deadlines for perfecting a lien claim for retainage would have to have expired in order to object to the lien.

Effective date. The bill would take effect on September 1, 2011, and would apply to a contract entered into on or after the effective date.

**SUPPORTERS
SAY:**

Under current law, subcontractors must file an affidavit claiming a retainage lien before the 30th day after project completion. However, the owner is required to hold retainage until after the 30th day. Under the current system, the owner's title must be encumbered for the subcontractor to protect its retainage. This is similar to initiating collection efforts before a bill is due. Subcontractors would generally prefer not to file a lien affidavit if it is not necessary because of business reasons. A lien clouds the owner's title, making the owner unlikely to rehire the subcontractor who filed the lien for future projects. CSHB 1390 would solve this problem by introducing a later deadline for filing a lien affidavit.

Under current law, a subcontractor must notify an owner about a retainage clause two and a half months after the subcontractor begins work. Notice to the owner at this time is unnecessary because the owner is required to hold 10 percent regardless of whether notice is provided. Notice at this point can cause confusion for the owner as well as unnecessary calls to the general contractor. CSHB 1390 would delay the required notice until closer to the time the owner would release retainage. The bill would benefit subcontractors who did not fully understand the perfection process when they began work by changing the notice deadline to after the subcontractor finished the project.

Real estate closings would not be delayed by this change unless there were subcontractors who had not been paid outstanding retainage.

Timelines for notice to owners and filing an affidavit for claiming a retainage lien already exist under current law. However, contractors can lose their lien rights if they do not know when a project was completed because the deadline for filing an affidavit for claiming a retainage lien

depends on project completion. HB 1390 would protect contractors by requiring owners to provide notice of completion.

OPPONENTS
SAY:

CSHB 1390 could cause owners to delay the distribution of retained funds. The current notice system provides owners with an early idea of which subcontractors might have retainage claims. Under the bill, owners would not receive notice of potential claims until much later. To protect themselves, owners likely would delay retainage payments until they felt was safe to release the funds, which could be as late as the 15th day of the fourth month after completion of the project. Delayed payment would hurt small businesses operating on slim margins.

The bill could delay real estate closings because liens could be filed as late as the 15th day of the fourth month after project completion, rather than 30 days after completion under current law. Longer closings are not ideal because more things can go wrong before the transaction is completed. A longer closing could result in a more expensive transaction.

The bill could adversely affect lien perfection for contractors because it would create a complex system that would be difficult to understand. The bill would create a series of timelines for providing notice to owners and filing an affidavit for claiming a retainage lien. If a contractor did not properly follow these timelines, the contractor would not have a valid lien.

NOTES:

The committee substitute differs from the original by altering the timeline for notice to an owner of a retainage claim and the deadline for filing an affidavit claiming a retainage lien.

The companion bill, SB 590 by Estes, was considered in a public hearing by the Senate Business and Commerce Committee on March 15 and was left pending.