The Construction Report

Volume 9 Issue 1 October 2009

Published periodically by Quilling, Selander, Cummiskey & Lownds, P.C., 2001 Bryan Street, Suite 1800, Dallas, Texas 75201
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Removables – A Contractor's Last Best Chance to Collect for Construction Work

A construction contractor deserves to be paid for good work. Filing a mechanic's lien can provide some assurance. But the pesky problems of lender foreclosure and bankruptcy can extinguish the lien. All is not lost. The right of removables may hold the key.

A savvy lender will ensure that it holds the first lien on a construction project. To establish a first lien position, the lender will file its deed of trust in advance of any visible appearance of construction on the property. A conscientious lender may require that the owner and contractor execute an affidavit of no construction, and inspect and photograph the property to verify that no construction has commenced. Provided that the lender's deed of trust was filed of record before any visible construction had occurred on the property, the lender's interest in the property will prime that of any construction contractor, vendor or supplier, with one exception – removables.

The right of "removables" may hold the key to unlock a deed of trust lien.

This scenario can develop in a number of ways: the owner defaults on its construction loan and its lender forecloses on the deed of trust and either takes title or transfers title to the property; or an owner-developer fails to pay for construction labor and materials before selling all or part of the project; or an original contractor fails to pay for labor and materials and a subcontractor or supplier files a mechanic's lien; or the owner or original contractor files for bankruptcy, and subcontractors or suppliers file mechanic's liens asserting a claim to "removables."

"Removables" are defined as fixtures which may be removed without material injury to the land and pre-existing improvements or to the fixtures themselves. See, *First Nat'l Bank v. Whirlpool Corp.*, 517 S.W.2d 262, 269 (Tex. 1974).

A statutory mechanic's lien only attaches to land and items that have become annexed to land, such as improvements (including fixtures), but not to chattel (personal property). Tex. Prop.

Code §53.022. *Whirlpool*, 517 S.W.2d at 266. A statutory mechanic's lien was meant to encumber "realty and such personal property as has been incorporated or consumed in the construction or repair thereof or delivered for such purposes." *Id*. Chattels incorporated into the realty become "fixtures" and are subject to a statutory mechanic's lien. *Id*. at 266-67. A statutory mechanic's lien therefore attaches to items that have become fixtures and such lien

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Lawyer Quips and Quotes

The devil visited a lawyer's office and made him an offer. "I can arrange some things for you, " the devil said. "I'll increase your income five-fold. Your partners will love you; your clients will respect you; you'll have four months of vacation each year and live to be a hundred. All I require in return is that your wife's soul, your children's souls, and their children's souls rot in hell for eternity."

The lawyer thought for a moment. "What's the catch?" he asked.

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A judge, bored and frustrated by a lawyer's tedious arguments, had made numerous rulings to speed the trial along. The attorney had bristled at the judge's orders, and their tempers grew hot. Finally, frustrated with another repetition of arguments he had heard many times before, the judge pointed to his ear and said, "Counselor, you should be aware that at this point, what you are saying is just going in one ear and out the other."

"Your honor," replied the lawyer, "That goes without saying. What is there to prevent it?"

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My favorite poem is the one that starts 'Thirty days hath September' because it actually tells you something.
—Groucho Marx, comedian

A successful person is one who can lay a firm foundation with the bricks that others throw at him or her.
—David Brinkley, TV broadcaster

If the only tool you have is a hammer, you tend to see every problem as a nail.
—Abraham Maslow,
American psychologist

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will be superior to a prior deed of trust lien when the fixtures can be removed without material injury to the land and pre-existing improvements or to the fixtures themselves. *Id*. at 269.

So, even assuming that a lender has a first lien on a project, and the lender forecloses and takes title to the project, or sells the project, a properly perfected lien claimant still has rights to the removables. Such rights out rank both that of the lender or a subsequent purchaser. Moreover, removables can pose a nightmare for a title company. See, *GCI GP, LLC v. Stewart Title Guar. Co.*, 2009 WL 943777 (Tex.App. – Houston [1st Dist.] 2009)(title insurer owes indemnity for attachment of mechanic's lien to removables).

This legal principle is also applicable in bankruptcy proceedings, as liens on removables that pre-date the bankruptcy filing must be addressed.

Having a valid lien on removables gives a claimant some collection options. The claimant can exercise self help and retrieve its removables if doing so will not breach the peace. In other words, if the property owner has no objection, the claimant may retrieve its removables without having to file legal proceedings. If the property owner will not acquiesce, the claimant has to file a legal claim to the removables, and seek a court order authorizing retrieval.

The judge or jury determines whether a particular improvement qualifies as a "removable."

Alternatively, the claimant can use its removables claim as leverage to negotiate payment from the property owner to avoid removal of the removables. For example, an air conditioned office building will have unhappy tenants if the claimant removes HVAC equipment from the roof or grounds. A property owner would be motivated to negotiate in good faith to avoid heat from its tenants.

The determination whether a particular improvement qualifies as a "removable" is for the trier of fact (jury if one is selected, otherwise the judge).

Improvements which have been held to be removable include: garbage disposals and built-in dishwashers, *First Nat'l Bank v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1974); mirrors that will be broken at a rate of 6% during the removal process, *Occidental Nebraska Federal Sav. Bank v. East End Glass Co.*, 773 S.W.2d 687 (Tex.App. – San Antonio 1989, no writ); carpets, appliances, air conditioning components, smoke detectors, burglar alarms, light fixtures and door locks, *Richard H. Sikes, Inc. v. L & N Consultants, Inc.*, 586 S.W.2d 950 (Tex.Civ.App. – Waco 1979, writ ref'd n.r.e.); windows and doors that could be removed by temporarily displacing the brick and trim around them, materially undamaged, *First Continental Real Estate Investment Trust v. Continental Steel Co.*, 569 S.W.2d 42 (Tex.Civ.App. – Fort Worth 1978, no writ).

Improvements held not to be removable (principally due to the material injury removal would cause) include: roofing tiles, *Exchange Savings & Loan Assoc. v. Monocrete Pty. Ltd.*, 629 S.W.2d 34 (Tex. 1982); cabinets, *Houk Air Conditioning, Inc. v. Mortgage & Trust, Inc.*, 517 S.W.2d 593 (Tex.Civ.App. – Waco 1974, no writ); brick used to veneer home and construct fireplace and chimney, *Chamberlain v. Dollar Savings Bank*, 451 S.W.2d 518 (Tex.Civ.App. – Amarillo 1970, no writ); a shell home, *Irving Lumber Co. v. Alltex Mortgage Co.*, 446 S.W.2d 64 (Tex.Civ.App. – Dallas 1969), aff'd on other grounds, 468 S.W.2d 341 (Tex. 1971); lumber used to build a house, *Cameron County Lumber Co. v. Al & Lloyd Parker, Inc.*, 122 Tex. 487, 62 S.W.2d 63 (1933); window frames, *McCallen v. Mogul Prod. & Ref. Co.*, 257 S.W. 918 (Tex.Civ.App. – Galveston 1923, writ dism'd); painting and plastering, *R.B. Spencer & Co. v. Brown*, 198 S.W. 1179 (Tex.Civ.App. – El Paso 1917, writ ref'd); duct work and piping, sheet rock, electrical conduit, wiring, and junction boxes, electromagnetic insulation, glass brick interior wall, and suspended ceiling. *In re Orah Wall Financial Corp.*, 84 B.R. 442 (Bankr. W.D. Tex. 1986).

Often, the removables are worth more to the property owner than to the claimant due to the inconvenience and trouble that removal would cause. Often, removal will render the property unusable or unsellable. Claimants can use these realities to great advantage.

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The Editor's Corner

The Construction Report is published periodically by Quilling, Selander, Cummiskey & Lownds, P.C., to highlight construction matters of interest to at least the Editor, Brian W. Erikson. The information we provide is a community service and is not intended to displace the legal judgment of your attorneys. Write us c/o ***Brian W. Erikson****, 2001 Bryan Street, Suite 1800, Dallas, Texas 75201. Call us at* ***(214) 880-1844****. Website: http://www.theconstructionreport.org*

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Time flies like an arrow. Fruit flies like a banana.
—Groucho Marx, comedian

I have not failed. I've just found 10,000 ways that won't work.
—Thomas Edison, inventor

If you rest, you rust.
—Helen Hayes, actress

Whenever I feel blue, I start breathing again.
—L. Frank Baum, author of The Wonderful Wizard of Oz

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electrical control panels, appliances, wine cooler units, fireplace mantel, decorative columns, mahogany columns and paneling, custom carved moldings, elevator, light fixtures, bathtubs or whirlpools, stained glass doors and panels, window treatments, steam unit, dry sauna, water heaters, safes, cabinets, marble or granite or composite countertops, plumbing valves and fixtures, exterior stone (not installed), antique entry doors, wrought iron fencing, landscape plants, carpet in the guest house, and windows and doors.

Gulf Coast demanded that Stewart indemnify Gulf Coast from Aspen's suit. Stewart agreed to provide a limited defense. Stewart's attorney wrote to Gulf Coast and opined that Aspen's lien was extinguished by the foreclosure sale, but the contractor may still have a claim for "removables." Gulf Coast and Aspen later settled, and Aspen dismissed its claims and released its liens. Stewart then denied coverage since there was no longer any claim pending against Gulf Coast's interest in the property, and Gulf Coast's policy claim had been resolved without any loss being demonstrated.

Gulf Coast then sued Stewart for breach of the title insurance policy. Stewart responded with a motion for summary judgment contending that the policy did not cover claims made against an insured by a contractor who furnished and was not paid for "removables" – improvements that could be removed without causing material damage to land, pre-existing improvements, or the improvements themselves. Stewart argued that as a matter of law, the items involved with Aspen's claim were personal property, not part of the real property described in the policy, and thus not covered by the policy.

Gulf Coast countered by filing a motion for partial summary judgment, asserting that the policy insured against loss or damage sustained by the lack of priority of Gulf Coast's lien over any mechanic's lien having an inception before the policy date. Gulf Coast alternatively argued that even if the title policy insured only against a lack of priority when a mechanic's lien was against the real property described by the policy, coverage still existed because "removables" are not personal property once they are affixed to the land, since they become part of the real property.

The trial court granted Stewart's motion for summary judgment, and Gulf Coast appealed.

On appeal, the Houston Court of Appeals first construed the title policy. The court observed that the policy provided coverage for losses or damages related to (1) the quality of the title; (2) the exercise of various rights under the title or lien; and (3) the priority of the lien on the insured mortgage over other

liens or encumbrances. Gulf Coast argued that Aspen's liens were superior to Gulf Coast's lien to the extent that the contractor's improvements were "removables," i.e., they could be removed without material injury to the land and pre-existing improvements or to the improvements themselves. According to Gulf Coast, because Aspen's liens on "removables" were superior to Gulf Coast's lien, Stewart was required to indemnify Gulf Coast for any loss or damage arising from the priority of the contractor's liens.

Stewart countered that losses arising from Aspen's liens were not covered by the policy because the liens were to items that could be removed, hence the name "removables," and therefore not "a claim to the land that was insured," but a claim to "items of personal property." Stewart's argued that its policy insures the priority of the mortgage lien only over other liens that attach to the land. According to Stewart, if the "risk [or] claim" is not "against the land," as land is defined in the policy, there was no coverage.

The appellate court disagreed. The court noted that mechanic's liens whose inception is subsequent to the date of a deed of trust lien will be subordinate to the deed of trust lien, citing *Diversified Mortgage v. Blaylock*, 576 S.W.2d 794, 806 (Tex. 1978). However, the court continued, Texas statutes and case law provide that mechanic's liens whose inception date is subsequent to the recording of a deed of trust lien will, nevertheless, have priority over a previously recorded deed of trust lien in one narrow instance. The court stated that Texas Property Code §53.123 granted a priority to a mechanic's lien on improvements over a prior lien, encumbrance, or mortgage on the land when the improvements made could be removed without material injury to the land and pre-existing improvements or to the improvements, themselves, citing *First Nat'l Bank in Dallas v. Whirlpool Corp.*, 517 S.W.2d 262, 269 (Tex. 1974).

The court reasoned that a statutory mechanic's lien may only attach to land and items that have become annexed to land, such as improvements (including fixtures), but not to chattel (personal property). The court concluded that a statutory mechanic's lien may therefore attach to items that have become fixtures and such lien will be superior to a prior deed of trust lien when the fixtures can be removed without material injury to the land and pre-existing improvements or to the fixtures themselves.

As a result, the court determined that the title policy provided coverage for "removables" and reversed the summary judgment in Stewart's favor.

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Pro golfer John Daly sued the Florida Times-Union in 2005 for allegedly libeling him when the newspaper suggested in a column that he failed "the scoundrel sniff test." But Duval County Circuit Judge Hugh Carithers dismissed Daly's libel suit ruling that columnist Mike Freeman's statements were either true or constitutionally protected opinion.

Seems like the decision to sue in the first place was out of bounds.

Removables – A Title Insurer's Nightmare

The right of removables can be a nightmare for title insurers. A title insurer may certify clear title, only to discover in horror that a statutory mechanic's lien was filed after closing the sale of a construction project.

Unfortunately for title insurers, the inception (legally effective) date for a mechanic's lien arising from the furnishing of labor or materials for a construction project is the date that construction improvements first became visible, and not the date of lien filing. Tex. Prop. Code §53.124. So, while title may have appeared clear on the day of closing, it could subsequently be clouded by a mechanic's lien, much to the insurer's dismay.

In *GCI GP, LLC v. Stewart Title Guar. Co.*, 2009 WL 943777 (Tex.App. – Houston [1st Dist.] 2009), an individual contracted to renovate his home. The contractor ("Aspen") worked on the home for about six years, until it stopped due to non-payment. In 2001, about four years into the renovation project, the owner took out a loan of more than $4.3 million, secured by a deed of trust on the home. The lender purchased a mortgagee policy of title insurance from Stewart Title, with coverage equal to the loan amount.

About 1½ years later, Aspen filed a statutory mechanic's lien for more than $800,000 for labor and materials it spent to improve the property.

The owner defaulted on its loan, and the lender noticed the property for a foreclosure sale. After unsuccessfully negotiating with the lender over lien priorities, Aspen filed suit against owner and lender. The same day, the lender sold the loan and deed of trust to Gulf Coast, for $4 million. Three days later, Gulf Coast went forward with the scheduled foreclosure sale, and purchased the property itself for a $2 million credit against the loan.

Aspen amended its suit to name Gulf Coast as a party. In the suit, Aspen claimed that it had an oral contract with the owner to improve the home and that it had furnished labor and materials from June 18, 1997, to August 2003. Aspen contended that the inception date for its lien was June 18, 1997, the first date of work on the project, and that its lien pre-dated the filing of the lender's deed of trust. Aspen also sought to foreclose on removables, that is, those fixtures which could be removed without damage to the home or the fixtures themselves. The listing of removables was extensive: palm trees, pool equipment, air conditioning units,

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