I. UNDERSTANDING THE BASICS OF MECHANIC'S LIEN LAW

A. Mechanic's Lien – Defined in Simple Language

In olden days, when an artisan manufactured or repaired an item, the artisan had the legal right to hold the item to ensure payment. If the artisan relinquished possession of the item, the artisan effectively released all right to any lien on the item. The key to the artisan's legal position was possession of the item. In other words, possession was more than 90% of the law. However, contractors did not enjoy such rights. When a contractor constructed a building for an owner, the contractor invariably released possession of the building perhaps at nights or on weekends, and certainly at the completion of the project. When the contractor released possession of its work, the contractor legally forwent any lien against the property for the value of the work.

Mechanics' liens as we know them did not exist under the common law either in England or the United States. Although courts in equity had greater inherent ability to do justice, they too were powerless to enforce a mechanics' lien. If a contractor built a project for an owner, and then was not paid, the contractor had only a personal action against the owner, and no lien on the owner's property. Recognizing this inherent inequity, legislatures in the United States began passing remedial statutes to allow an enforceable lien to those who worked on real property.

The first mechanics' lien law in the United States was passed by the Maryland legislature in 1791 to promote development of the new city of Washington. Pennsylvania followed in 1803. Since then, every state in the country has passed some sort of mechanics' lien law. Mechanics' lien laws allowed contractors some security of payment and enticed them to invest capital in buildings and other projects. Mechanics' lien laws have been credited with the expansive growth of cities and towns across the country in the nineteenth century.

The first mechanic's lien statute in Texas was passed in 1839. At first, mechanic's liens in Texas were remarkably easy to perfect -- there was no filing or notice requirement. Although today, Texas protects the right to a mechanic's lien under both the Texas Constitution and state law, perfecting a lien is no longer easy for subcontractors or suppliers.

1. What is a Mechanics' Lien?

A mechanic's lien is a legal attachment to real property which arises with the occurrence of specified conditions. A mechanic's lien is created only by the operation of law, not by grant or contract.

There are two schools of legal thought underlying mechanic's lien statutes -- New York versus Pennsylvania. The fundamental difference between the views is the way in which they treat subcontractors' rights. Texas follows the New York approach, which limits the value of the subcontractor's lien to that portion of the contract price that the owner owes to the original contractor at the time that the lien notice is given, plus any amount which may become due thereafter. To succeed on a lien claim, the subcontractor must show that the owner owed the amount of the claim or more to the original contractor. The owner usually owes no more than the contract price. Under the New York scheme, the owner is not liable to claimants for amounts which he has already paid to the original contractor prior to the filing of liens. The owner can freely pay the original contractor without concern for potential subcontractor claims, provided that (in some New York-scheme states) the owner does not deliberately try to defraud subcontractors.

The Pennsylvania approach is much more subcontractor friendly. With this approach, subcontractors have a direct lien, not merely a derivative right, on the owner's property for the full

value of the claim, regardless how much the owner has already paid to the original contractor. Under this view, the original contractor is considered the owner's agent for hiring and directing subcontractors. As a result, payments to the original contractor do not reduce the owner's liability to subcontractors. Owners in Pennsylvania-scheme states may face subcontractor claims far in excess of the original contract price.

B. Who Really is Entitled to a Lien?

The mechanic's lien statute which was first enacted in Texas was intended to benefit those contractors with whom the owner directly contracted. Contractors were enticed to provide labor and materials on credit in return for some security on the owner's property,. By 1844, Texas subcontractors were granted limited lien rights, but they have never gained the level of rights which original contractors enjoy.

Texas statutes and cases, as well as the constitution, have historically differentiated between the rights of original contractors or master mechanics, and materialmen, subcontractors, laborers, and others, but today there are only two principal classes of mechanic's lien claimants: original contractors and subcontractors, in addition to special provisions for architects, engineers, and surveyors who prepare plans and plats. The law controlling mechanic's liens is set out in Chapter 53 of the Texas Property Code.

1. Original Contractor

An original contractor is defined under Texas law as "a person contracting with an owner either directly or through the owner's agent." Texas Property Code §53.001(7). The owner under Chapter 53 is a person who owns any legal or equitable interest in the property sought to be charged

with the lien. *Diversified Mortgage Investors v. Blaylock*, 576 S.W.2d 794 (Tex. 1978). An original contractor is not required to do any actual work on a construction project, only be responsible for it to the owner. Any person who contractually agrees with the owner to furnish the labor and materials used in the construction of an improvement is an original contractor, regardless whether subcontractors or vendors actually do the heavy lifting. *Wilson v. Hinton*, 116 S.W.2d 365 (Tex. 1938).

Contracting with the owner's agent suffices to make one an original contractor. However, one who contracts to construct improvements as the owner's agent, and not as an independent contractor, cannot be an original contractor. *Dallas National Bank v. Peaslee-Gaulbert Co.*, 35 S.W.2d 221 (Tex.Civ.App. -- Dallas 1931, writ dism'd). A contractor with a cost plus contract with the owner may be an original contractor, as long as the contract evinces intent that the contractor be independent of the owner and not be the owner's agent. *Associated Sawmills, Inc. v. Peterson*, 366 S.W.2d 844 (Tex.Civ.App. -- Dallas 1963, no writ).

(a) Sham Contracts

Sometimes, the owner contracts with or arranges for a party to procure labor or materials for a construction project. That party need not perform any actual work, and ordinarily would be an original contractor based on the direct contract with the owner. However, a sham contract exists if the owner can effectively control the party or if the contract lacked any good faith intent that the other party have responsibility for performing the contract. When a sham contract exists between the owner and its agent, then any person who furnishes labor or materials under contract with the agent is elevated in status to an original contractor, with all the rights of an original contractor.

For example, some owners will contract with a construction manager, who in turn contracts

with trade contractors for labor and materials for the project. Under the owner-construction manager contract, the construction manager may not be responsible for any of the actual construction and is really the owner's agent for scheduling and coordination. In that case, the construction manager is not construed as the original contractor. Each trade contractors who contracts with the construction manager becomes an original contractor with concomitant rights of an original contractor.

2. Subcontractors

A subcontractor is a person who has furnished labor or materials to satisfy an obligation to an original contractor or to a subcontractor, where the obligation involves the performance of some or all of the work required by the original contract. Tex. Prop. Code §53.001(13). An original contract is defined as "an agreement to which an owner is a party directly or by implication of law." Tex. Prop. Code §53.001(6). The term "work" means "any part of construction or repair performed under an original contract." Tex. Prop. Code §53.001(14). Translating these definitions, the term "subcontractor" includes anyone who provides labor or material under a contract with an original contractor or another subcontractor, where the labor or material forms any part of the construction or repair required under an agreement to which the owner is directly or impliedly a party.

To define the term "subcontractor," the statute unfortunately uses the very term to be defined. This causes some confusion as to whether the term subcontractor is limited to only those who have contracted either directly with the original contractor or with one who has contracted with an original contractor. In other words, one could construe the statute to exclude liens for third-tier subcontractors, that is, those who have contracted with a sub-subcontractor to a subcontractor to an original contractor. However, a third-tier subcontractor becomes a "subcontractor" under the Property Code because it is furnishing labor or materials to fulfill an obligation to a subcontractor,

the second-tier subcontractor. A provider to the third-tier subcontractor would be in a similar position, as would the fourth-tier provider, and all lower tier providers. Under Tex. Prop. Code §53.021(a), anyone furnishing labor or material under a contract with any higher tiers is entitled to a lien if the work performed is required by the original contract for the project.

3. Others

It appears from the Property Code that anyone who furnishes labor or material for a specific project for some part of the work required by an original contract is entitled to a lien. It matters not whether the person to whom it is furnished is a supplier or a contractor. It matters not what particular tier the person occupies in the series of contracts pertaining to the project. Under Tex. Prop. Code §53.021, the class of persons entitled to a lien is defined broadly to include anyone who furnishes labor or material "under or by virtue of a contract with the owner or the owner's ... contractor, or subcontractor."

Architects who were engaged not only to design a structure, but also to supervise the construction of a building, have historically been entitled to a mechanic's lien because they were expending labor for the erection of the improvements. Today, an architect, engineer or surveyor is entitled to a lien for the mere preparation of a plan or plat, without regard to supervision of construction, if he or she complies with the requirements of Tex. Prop. Code §53.021(c).

C. What Property the Lien Covers – In a Nutshell

Texas Property Code § 53.022, is entitled: Property to Which Lien Extends. Section 53.022 states:

> (a) The lien extends to the house, building, fixtures, or improvements, the

land reclaimed from overflow, or the railroad and all of its properties, and to each lot of land necessarily connected or reclaimed.

(b) The lien does not extend to abutting sidewalks, streets, and utilities that are public property.

(c) A lien against land in a city, town, or village extends to each lot on which the house, building, or improvement is situated or on which the labor was performed.

(d) A lien against land not in a city, town, or village extends to not more than 50 acres on which the house, building, or improvement is situated or on which the labor was performed.

A mechanic's lien also extends to the leasehold interest of a tenant. Any person who contracts for and provides labor or materials to a tenant may acquire a lien against the tenant's lease rights, known as the leasehold estate. However, by themselves, neither the lien against the leasehold estate, nor the contract to do improvements for a tenant entitle a contractor to lien rights against the owner of the property. Unless the lien claimant can show that a tenant was acting as the agent of the landlord, in contracting for improvements to the leased property, the claimant usually lacks any significant lien rights on leasehold improvements.

D. What Types of Labor, Materials, and Services Are Lienable

A mechanic's lien does not exist independently from the debt owed for labor or materials for a construction project. The lien's creation is, in fact, an incident of the debt incurred to perform the type of work described in the constitution or in the mechanic's lien statutes. The lien may exist only so long as the debt exists. When the debt is discharged, the mechanic's lien is likewise discharged. *University Savings & Loan Ass'n v. Security Lumber Co.*, 423 S.W.2d 287 (Tex. 1967).

Under Tex. Prop. Code §53.023, a mechanic's lien secures payment for:

> (1) labor done or material furnished for construction or repair;
>
> (2) specially fabricated material, even if the material has not been delivered or incorporated into the construction or repair, less its fair salvage value;
>
> (3) the preparation of a plan or plat by an architect, engineer, or surveyor in accordance with Section 53.021(c).

Unless the debt is listed, it is not secured by a mechanic's lien.

Where the original contractor has a cost plus agreement with the owner, all the expense that the contractor incurred in building the project, including subcontractors' claims and a 10% prime contractor's fee, are lienable. *Lee v. Ardoin*, 677 S.W.2d 686 (Tex.App. -- Beaumont 1984, no writ).

Where sales tax is part of the price charged for the items purchased for a project, the tax is part of the lienable debt. *First National Bank in Dallas v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1974)(sales tax paid for garbage disposals and dishwashers properly recoverable under mechanic's lien).

Profit on the contractor's work actually performed is lienable. Anticipated profits on work

not performed is not lienable. *Texas Bank & Trust Co. v. Campbell Bros., Inc.*, 569 S.W.2d 35 (Tex.Civ.App. -- Dallas 1978, writ dism'd)(no lien for profit on work not performed).

A recent case, *Advance'd Temporaries, Inc. v. Reliance Surety Co.*, 2004 WL 1632737 (Tex.App. – Corpus Christi July 22, 2004), has held that a temporary employment agency which supplied employees to a subcontractor had a legal right to a mechanic's and materialman's lien for the employees' labor.

While debt incurred for labor and material furnished for a project is lienable, debt incurred for the loan of money to pay for labor and material furnished is not. *Gaylord v. Loughridge*, 50 Tex. 573 (1879)(one who advances money as loan for labor or materials for building project not entitled to mechanic's lien). Where a loan is disguised as a construction contract, the court will examine the substance not the form of the transaction.

In *Bunton v. Palm*, 9 S.W. 182 (Tex. Comm'n App. 1888, judgment approved), the court faced a loan purporting to be a construction contract. There, an owner issued a note to another person in return for money to pay for labor and material for the owner's homestead property. The transaction, however, never envisioned that the lender would perform any work, and was in substance a loan. The lender assigned the note to another who attempted to assert a mechanic's lien as security for the note. The court held that, although the assignee paid value for the note, the assignee did not buy any mechanic's lien rights because the transaction was, in effect, merely a loan of money, secured by a contract lien on the property. A loan of money, even for labor and materials, does not give rise to a mechanic's lien. Here, the assignee had no right to a mechanic's lien.

The Texas Property Code allows the recovery of attorney's fees. However, any attorney's fees awarded are not part of the lienable debt secured by the lien. *Dossman v. National Loan*

Investors, L.P., 845 S.W.2d 384 (Tex.App. -- Houston [1st Dist.] 1992, writ denied). In other words, the attorney fee claim is a personal action against the owner, and is not part of the debt covered by the lien. However, the owner may agree to a contractual lien to secure the payment of attorney's fees on non-homestead property, such as those common in mortgages and deeds of trust. *Hufstedler v. Glenn*, 82 S.W.2d 733 (Tex.Civ.App. -- Austin 1935, no writ).

Prejudgment interest is similarly not protected by the mechanic's lien, since Section 53.023 limits the scope of the lien to payment for labor, material, special fabrication, and professional plan or plat preparation, and does not encompass prejudgment interest. *Ambassador Development Corp. v. Valdez*, 791 S.W.2d 612 (Tex.App. -- Fort Worth 1990, no writ).

A contractor or supplier may be able to apply payments received to any portion of the debt that the contractor or supplier chooses. If the debtor provides no direction as to what particular items are to be paid by a payment, the contractor or supplier is entitled to allocate the payment as it chooses, provided that the contractor or supplier does not make an application that is inequitable and unjust to the debtor. *First National Bank in Dallas v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1974); *Hodges v. Price*, 163 S.W.2d 868 (Tex.Civ.App. -- Galveston 1942, writ ref'd w.o.m.). A creditor's right to apply payments as it chooses is an exception to the general rule that the payment clears the oldest item then due. The defense that a payment paid for a particular item is an affirmative defense which must be specially pled. The debtor-purchaser has the burden of proof on such a defense. A general denial is insufficient. Texas Rules of Civil Procedure 94 and 95; *First National Bank in Dallas v. Whirlpool Corp.*, *supra*.

E. A Crash Course on Common Mechanic's Lien Terminology

Section 53.001 of the Property Code contains the following definitions:

> (1) "Contract price" means the cost to the owner for any part of construction or repair performed under an original contract.
>
> (2) "Improvement" includes:
>
> (A) abutting sidewalks and streets and utilities in or on those sidewalks and streets;
>
> (B) clearing, grubbing, draining, or fencing of land;
>
> (C) wells, cisterns, tanks, reservoirs, or artificial lakes or pools made for supplying or storing water;
>
> (D) pumps, siphons, and windmills or other machinery or apparatuses used for raising water for stock, domestic use, or irrigation; and
>
> (E) planting orchard trees, grubbing out orchards and replacing trees, and pruning of orchard trees.
>
> (3) "Labor" means labor used in the direct prosecution of the work.
>
> (4) "Material" means all or part of:
>
> (A) the material, machinery, fixtures, or tools incorporated into the work, consumed in the direct prosecution of the work, or ordered and delivered for incorporation or consumption;
>
> (B) rent at a reasonable rate and actual running repairs at a reasonable cost for construction equipment used or reasonably required and delivered for use in the direct prosecution of the work at the site of the construction or repair; or

(C) power, water, fuel, and lubricants consumed or ordered and delivered for consumption in the direct prosecution of the work.

(5) "Mechanic's lien" means the lien provided by this chapter.

(6) "Original contract" means an agreement to which an owner is a party either directly or by implication of law.

(7) "Original contractor" means a person contracting with an owner either directly or through the owner's agent.

(8) "Residence" means a single-family house, duplex, triplex, or quadruplex or a unit in a multiunit structure used for residential purposes that is:

(A) owned by one or more adult persons; and

(B) used or intended to be used as a dwelling by one of the owners.

(9) "Residential construction contract" means a contract between an owner and a contractor in which the contractor agrees to construct or repair the owner's residence, including improvements appurtenant to the residence.

(10) "Residential construction project" means a project for the construction or repair of a new or existing residence, including improvements appurtenant to the residence, as provided by a residential construction contract.

(11) "Retainage" means an amount representing part of a contract payment that is not required to be paid to the claimant within the month following the month in which labor is performed, material is furnished, or specially fabricated material is delivered. The term does not include retainage under Subchapter E.

(12) "Specially fabricated material" means material fabricated for use as a component of the construction or repair so as to be reasonably unsuitable for use elsewhere.

(13) "Subcontractor" means a person who has furnished labor or materials to fulfill an obligation to an original contractor or to a subcontractor to perform all or part of the work required by an original contract.

(14) "Work" means any part of construction or repair performed under an original contract.

(15) "Completion" of an original contract means the actual completion of the work, including any extras or change orders reasonably required or contemplated under the original contract, other than warranty work or replacement or repair of the work performed under the contract.

F. Up-to-the-Minute Coverage of Changing Laws

1. Legislative Update

(A). Mechanics Liens/Payment Bonds

HB 629 Relating to notice required for a mechanic's, contractor's, or materialman's lien in certain circumstances.

In *Page v. Structural Wood Components, Inc.*, 102 S.W.3d 720 (Tex. 2003), the Texas Supreme Court held that a subcontractor's deadline for filing a lien affidavit to perfect a retainage claim runs from the date the original contract was completed, terminated, or abandoned, even if the subcontractor had no knowledge as to when the original contract was terminated or abandoned. HB

629 remedies this problem by amending Texas Property Code Section 53.107 to require an owner to provide written notice to a subcontractor who has sent a lien notice or who has requested that the owner provide written notice whenever an original contract is either terminated or abandoned. If notice is not provided within ten days of termination or abandonment and the lien claimant otherwise properly perfects its lien claim, the owner will not be allowed to object on the grounds that an early termination or abandonment of the original contract shortened the subcontractor's time to perfect its lien claim. This provision does not apply to residential construction projects.

(B). Construction – General

HB 265 Relating to the time for processing a municipal building permit.

This provision creates section 214.904 of the Local Government Code, and requires municipalities to issue building permits on a timely basis (statutory time periods are provided – generally, 45 days to grant or deny). Failure to issue permits on a timely basis imposes obligations on the municipality to refund the permit fee.

HB 266 Relating to the time for processing a county building permit.

This provision creates section 233.901 of the Local Government Code, and requires counties (with populations of 3.3 million or more) to issue building permits on a timely basis (statutory time periods are provided – generally, 45 days to grant or deny). Failure to issue permits on a timely basis imposes obligations on the county to refund the permit fee.

SB 1458 Relating to the adoption of a uniform commercial building code for use in the state.

This provision amends section 214.211 of the Local Government Code to mandate the establishment of the International Building Code as the basis for all municipal and local governmental building codes for commercial construction. Cities will be able to modify code provisions (provided such modifications call for greater or more strict requirements). Code requirements are also extended after January 1, 2006, to all unincorporated areas, and counties are given ordinance making powers to enforce.

(C). Construction – Licensing

HB 854 Relating to an action for damages alleging professional negligence by a registered professional land surveyor.

This provision amends section 150.001 of the Texas Civil Practice & Remedies Code, to extend the requirement for a certificate of merit as a condition for bringing a professional liability claim against professional land surveyors.

HB 1573 Relating to the definition of the practice of architecture.

This provision amends section 1051.001(7) of the Texas Occupations Code to revise the definition of the practice of architecture for purposes of requiring an architectural license to include the following:

(a) establishing and documenting the form, aesthetics, materials and construction technology for building construction or alteration;

(b) preparing (or supervising and controlling the preparation of) architectural plans and specifications that include all integrated building systems and

construction details;

(c) observing construction to evaluate conformance with plans and specifications;

(d) programming for construction projects, including identification of economic, legal, and natural constraints and determination of scope and spatial relationships of functional elements;

(e) recommending and overseeing appropriate delivery systems;

(f) consulting, investigating, and analyzing design, form, aesthetics, materials, and construction technology for construction or alteration, and providing expert opinion or testimony as necessary;

(g) research to expand the knowledge base of the profession of architecture, including publishing and presenting findings in professional forums; and

(h) teaching, administering, and developing pedagogical theory in academic settings offering architectural education.

HB 1573 also amends "Certificate of Merit" provisions in Chapter 150 of the Texas Civil Practice & Remedies Code to require the certificate as a pre-requisite for arbitration. HB 1573 also extends certificate of merit requirements for suits and arbitration proceedings against any firms in which such licensed professionals practice (not just in suits against individual licensed professionals) and expressly requires dismissal for failure to furnish a certificate of merit (dismissal with prejudice is authorized but not mandated). The certificate of merit requirement applies to any claim relating to professional services (not just professional negligence) other than a suit for the payment of fees.

The revisions to Chapter 150 apply to licensed professional engineers as well as architects.

(D). Construction – Public Works

HB 664 Relating to consideration of a bidder's principal place of business in awarding certain municipal and school district contracts.

This provision creates section 271.9051 of the Texas Local Government Code, and amends section 44.033 of the Texas Education Code to give a city with a population under 250,000, and an independent school district which has its central administrative offices in a city with a population under 250,000, the authority to give a 5% preference for purchasing services when bid by a local contractor.

HB 908 Relating to a pilot program on the use of the reverse auction procedures by the Building and Procurement Commission.

This provision adds section 2155.085 of the Texas Government Code, which instructs the Texas Building and Procurement Commission to use reverse auctions for the purchase of goods and services when procedure provides best value to the State or all purchasing methods provide equal value to the State. The Commission is required to set a goal of at least 20% of the dollar value of purchased goods and services to be procured by the reverse auction procedure. The Commission is also directed to offer HUB's special assistance and training relating to the reverse auction for construction or professional services; however, that provision was deleted in the final version of the bill.

HB 1826 Relating to the use of school district resources for the maintenance of real property not owned or leased by the district.

This provision adds section 11.168 to the Texas Education Code to prohibit school districts from contracting to perform private construction and maintenance with school district employees and property. This legislation was in response to school districts which were contracting as general contractors with third party owners for the construction of various public and private projects (unrelated to the construction or repair of the district's own school facilities).

HB 2659 Relating to bond requirements for privatized maintenance contracts.

This provision amends section 223.042 of the Texas Transportation Code to require the contractor to furnish a payment bond for a maintenance contract (the current statute only requires a performance bond).

HB 2661 Relating to the use of competitive sealed proposals for certain construction projects.

This provision amends section 252.043 and section 271.116 of the Texas Local Government Code, and authorizes local governmental entities on smaller highway type construction projects (under $1.5 million) to use competitive the sealed proposal procurement method (rather than just competitive bidding).

SB 1544 Relating to purchasing practices of public junior colleges and community college districts.

This provision amends section 44.031 and Chapter 130 of the Texas Education Code to authorize junior colleges and community college districts to use alternative delivery systems

(including design/build) and procurement procedures (including competitive sealed proposals) similar to those authorized for other educational institutions.

(E). Construction – Claims on Governmental Projects

HB 1940 Relating to alternative dispute resolution of certain contract claims against the State.

This provision amends Chapter 2260 of the Texas Government Code (relating to dispute resolution procedures for state construction contracts) to expressly authorize recovery of delay damages (caused by the governmental entity). HB 1940 also expressly allows a contractor who has been sued by a governmental entity to seek recoveries by counterclaim without going through the procedural requirements of Chapter 2260, speeds up the procedural requirements for parties bringing action under the Chapter, and gives a party the right to appeal the administrative order on the basis of an abuse of discretion. It also modifies the provisions which control payment by the agency without additional legislative authorization – requiring such payment of an enforceable order if the recovery is not greater than 25% of the contract.

HB 2039 Relating to the adjudication of claims arising under written contracts with local governmental entities.

This provision adds Subchapter I to Chapter 271 of the Texas Local Government Code to provide for an express waiver of sovereign immunity for claims arising from the sale of goods or services with local governmental entities. The statutory waiver of sovereign immunity in HB 2039 applies to all governmental entities, including municipalities, special purpose districts, schools and authorities, other than the State of Texas and counties. Under the statutory waiver provided by HB

2039, recoveries are limited (no consequential damages, exemplary damages, or home office overhead) and there is no waiver of sovereign immunity in federal court or for tort claims. HB 2039 went into effect on September 1, 2005; however, it was retroactive with regard to all claims against governmental entities to the extent that those entities had exercised sovereign immunity from suit prior to September 1, 2005.

HB 2988 Relating to waiver of sovereign immunity.

This provision amends section 311.034 of the Texas Government Code to provide that statutory requirements with regard to sovereign immunity, including notice provisions, are jurisdictional (which would allow an immediate appeal of the issue).

2. Recent Case Law

(A). Page v. Structural Wood Components, Inc., 102 S.W.3d 720 (Tex. 2003).

Page hired Sepolio as a general contractor on a remodeling and expansion project for a building in Houston. Sepolio in turn retained several subcontractors including Structural Wood Components to provide labor and materials. Structural Wood completed its portion of the work in March 1998. Before the project was finished, Page and Sepolio had a dispute, and Page terminated his contract with the general contractor on April 14, 1998. Page then hired six new contractors to complete the construction. Since Structural Wood had not been paid in full, Structural Wood filed an affidavit claiming lien on the property on May 15, 1998, thirty-one days after Page had terminated his contract with Sepolio. Structural Wood subsequently filed suit to foreclose on its lien. After a bench trial, the trial court concluded that the work was completed on July 21, 1998, when the

replacement contractors finished the project. The trial court held Page and Sepolio liable for Structural Wood's claims. *Id*. at 721. On appeal, the court of appeal also found that the project was complete in July 1998, and that Structural Wood's lien was timely. *Id*.

On appeal, the Supreme Court observed that the Texas Property Code required owners to maintain ten percent retainage until 30 days after the work was completed. The court noted that a subcontractor or other claimant against the retainage must properly give notice and file "an affidavit claiming a lien not later the 30th day after the work is completed." *Id.* at 722. The court then had to determine when the 30 day period ended. Page focused on the phrase "under an original contract" and contended that work under an individual contract should be deemed completed when the contract is terminated or abandoned, since no more work would be contemplated under the contract at that point. *Id*. at 722-23. Structural Wood focused instead on the word "contemplated" and argued that since the statute required "actual completion of the work ... reasonably required or contemplated under the original contract," a court should determine completion based on when all the work initially contemplated under the original contract was finished. *Id.* at 723. Structural Wood contended that Page's interpretation would work a hardship on subcontractors who must file lien affidavits in a shorter time without ever knowing if an owner had terminated the general contractor. *Id*.

The Supreme Court concluded that the work ended when the contract was terminated, thus starting the 30 day period for the owner to hold retain retainage and for lien claimants to file their lien affidavits. *Id*.

(B). Page v. Marton Roofing, Inc., 102 S.W.3d 733 (Tex. 2003).

In a companion case to *Page v. Structural Wood Components, Inc.*, 102 S.W.3d 720 (Tex. 2003), the Texas Supreme Court examined the funds trapping provisions of the Texas Property Code. The facts indicated that Page had hired Sepolio to remodel and expand a Houston building. Sepolio retained several subcontractors to including Marton Roofing to work on the project. After a dispute with Sepolio, Page terminated Sepolio's contract on April 14, 1998, and hired six replacement contractors to finish the project. When Sepolio failed to pay, Marton sent Page a notice of non-payment on May 21, 1998, and filed a lien affidavit on June 15, 1998. Marton later filed suit against Page arguing that Page was liable for the unpaid invoices under both the statutory retainage provision of Texas Property Code section 53.103, and the fund trapping provision of Property Code section 53.081. The trial court granted Marton a summary judgment, which the court of appeals affirmed. *Id*. at 734.

The Supreme Court reversed relying on *Structural Wood* holding that since the work must be defined in relation to a particular contract, a subcontractor must file its lien affidavit within thirty days of the time that the original contract is completed, terminated, or abandoned. Since Marton filed its lien affidavit two months after the original contract was terminated, the court held that Marton had failed to perfect a lien on the statutory retainage. *Id*.

The court also held that Marton did not perfect a fund trapping claim for similar reasons. The court stated that the statutory fund trapping provision allows subcontractors to "trap, in the owner's hands, funds payable to the general contractor if the owner receives notice from the subcontractors that they are not being paid." *Id*. However, here, the court found that Page neither made nor owed any further payments to Sepolio at any time after Page received notice of Marton's claims. The court declared that as with retainage liens, fund trapping liens must be judged in relation to individual

contracts. The court observed that Marton's notice authorized Page to withhold funds from Sepolio, because Sepolio was the original contractor that hired Marton. Page was not authorized to withhold funds from the replacement contractors who had no relationship to Marton. As a result, the court held that Page could not be liable under the fund trapping statute for any funds paid to the replacement contractors. *Id*. at 735.

(C). Advance'd Temporaries, Inc. v. Reliance Surety Co., 2004 WL 1632737 (Tex.App. – Corpus Christi 2004).

In a case of first impression, a temporary employment agency sought to collect from a payment bond surety for wages paid to temporary employees on a construction project. The trial court held that the agency had no standing to assert lien rights under Chapter 53 of the Texas Property Code. The agency had contracted with a subcontractor on an apartment construction project to provide temporary employees for the subcontractor's use on the project. The agency invoiced the subcontractor weekly for as many as 100 employees. The agency paid the employees and withheld and processed appropriate payroll deductions. When the subcontractor did not pay the agency, the agency asserted a claim against the payment bond for the general contractor. After a bench trial, the trial court entered judgment in favor of the agency against the subcontractor, but against the agency in connection with its claims against the general contractor, the payment bond surety and the owner. *Id*. at **1.

On appeal, the agency challenged the trial court's determination that the agency was not a person entitled to the benefits of the mechanic's lien statutes. The agency contended that it was entitled to recover against the payment bond because through its contract with the subcontractor, the

agency had provided labor in the direct prosecution of the work. The general contractor and the surety contended that the agency's services were payroll and administrative, and were not in the nature of labor or work as contemplated by the Property Code. *Id*.

The court of appeals reviewed the purpose and nature of mechanic's liens to determine the merits of the agency's claim:

> In Texas, the law recognizes two forms of mechanic's liens: constitutional and statutory. The most common, applicable here, is found in chapter 53 of the Texas Property Code. Section 53.021 states:
>
> (a) A person has a lien if:
>
> (1) the person labors, specially fabricates material, or furnishes labor or materials for construction or repair in this state of:
>
> (A) a house, building or improvement;
>
> (B) a levee or embankment to be erected for the reclamation of overflow land along a river or creek; or
>
> (C) a railroad; and
>
> (2) the person labors, specially fabricates the material, or furnishes the labor or materials under or by virtue of a contract with the owner or the owner's agent, trustee, receiver, contractor, or subcontractor.
>
> TEX. PROP.CODE ANN. § 53.021(a)(1), (a)(2) (Vernon Supp.2004). The purpose of the statutory mechanic's lien is to protect laborers and materialmen who come within its terms for labor and materials consumed in the construction of improvements to real property. South Coast Supply Co. v. A & M Operating Co. (In

> re A & M Operating Co.), 182 B.R. 986, 991 (Bankr.D.Tex.1993). No protection is afforded those who labor to produce or repair chattels. *Id*. A subcontractor in Texas is entitled to a lien when furnishing labor or materials for construction or repair of a building under or by virtue of a contract with the owner or the owner's subcontractor. TEX. PROP.CODE ANN. § 53.021(a)(1)(A), (a)(2) (Vernon Supp.2004). However, the statute is not designed to protect only subcontractors. Rather, the supreme court has held that "the mechanic's and materialman's lien statutes of this State will be liberally construed for the purpose of protecting laborers and materialmen." Page v. Structural Wood Components, 102 S.W.3d 720, 723 n. 3 (Tex.2003) (quoting First Nat'l Bank v. Whirlpool Corp., 517 S.W.2d 262, 269 (Tex.1974)).

Id. at **2.

The court observed that the usual building contract imposed the duty to pay for labor and materials primarily on the contractor. *Id*. at **3. The court stated that when a subcontractor failed to perform its obligations, the loss should fall on the contractor, who should be supervising the subcontractor's activities. The court noted that a materialman's right to recover is not dependent on the status of the accounts between the general contractor and the subcontractor. *Id*. The court saw no distinction in the treatment for one who furnished labor. The court stated that otherwise it would "deprive those furnishing labor of substantial and certain benefits that the lien statutes are designed to provide. *Id*.

The court held that Chapter 53 of the Property Code protects those who "furnish labor" as

well as those who actually labor on a construction project. *Id*.

(D). Texas Wood Mill Cabinets, Inc. v. Butter, 117 S.W.3d 98 (Tex.App. – Tyler 2003).

Texas Wood Mill Cabinets was retained to design and build cabinets for a the construction of a speculative home. Texas Wood undertook its initial installation in May 1999, with additional work on June 17 and July 5, 1999. On June 18, 1999, the owner of the spec home entered into a contract entitled "New Home Contract (Incomplete Construction)" to sell the property to the Butters. The sale of the home closed on July 6, 1999. Texas Wood was not paid for its cabinets, and on October 11, 1999, Texas Wood filed an affidavit claiming lien as an original contractor. The same day, Texas Wood sent a copy of the lien to the original owner and the Butters by certified mail. On September 1, 2000, Texas Wood sued the Butters to foreclose on its lien. The Butters claimed that they were subsequent purchasers and had neither actual nor constructive notice of Texas Wood's lien against the property. After a non-jury trial, the trial court granted judgment in favor of the Butters finding that the Butters were bona fide purchasers for value without actual or constructive knowledge of Texas Wood's cabinet work, and could not be bound by the lien. On appeal, the appellate court reversed.

The Butters contended that since a residential construction project was involved, the period for filing a lien was shortened by one month to the 15th day of the third month after the day on which the indebtedness accrued, as set out under Texas Property Code section 53.052(b). However, the court found that the home was constructed under a contract for a spec house, and not pursuant to a residential construction contract. As a result, the court declared that the one month longer period

allowed by section 53.052(a) was applicable, and Texas Wood's lien was timely, if Texas Wood's work was completed after May 1999. The Butters contended that Texas Wood's work was completed in May 1999, and that all work after that related to specific adjustments requested by the original owner on work already billed for and abandoned by Texas Wood. The court interpreted the term "completed" to mean "ended" or "concluded." The court found that the cabinet contract could not be "completed" until the cabinets were constructed, installed, and functional. The court found that the adjustments that Texas Wood made in June and July were necessary, and a usual part of cabinet construction, since the base cabinets must be installed before appliances and other components of the kitchen. *Id*. at 105.

The court then examined whether the Butters had constructive notice of the lien. The court observed that once a lien affidavit has been properly filed, the lien relates back in time to the inception of the contract. *Id*. The court stated that when a lien affidavit is filed after the property is sold by the owner who contracted for the improvements, the purchaser is deemed to have constructive notice of a contractor's right to assert a lien for the statutory period, even where the filing period commenced prior to the purchase. The court also noted that personal knowledge of improvements being made on the property shortly before the time the subsequent purchaser took possession of the property provides sufficient notice of a contractor's right to assert a lien claim. *Id*. The court found that the Butters had visited the house while it was under construction in June 1999, and held that the Butters had personal knowledge that improvements were being made to the property. The court held that the Butters' knowledge was sufficient to charge the Butters with constructive knowledge of Texas Wood's right to assert a lien claim during the statutory period. The court held that since Texas Wood's lien affidavit complied with statutory requirements and was

timely filed, even if the Butters had no personal knowledge of the improvements, they were charged with constructive notice of Texas Wood's right to assert a lien for the statutory period. *Id*. at 106-07.

(E). Dean v. Frank W. Neal & Associates, Inc., 2005 WL 1189173 (Tex.App. – Fort Worth 2005).

Homebuyers sued their construction contractor and engineer in connection with defects in the foundation of their home. The engineer had designed the home's foundation to accommodate potential movement of subsurface soils on the site. During construction, the engineer and the homebuyers noticed some cracks in the foundation. The engineer did not think that the foundation had been structurally compromised at that point and recommended that the cracks be repaired with an epoxy patch. Construction progressed and the homebuyers closed on the house in December 1996. After they moved in, the homebuyers noticed cracks in various places in the house. By October 1997, more cracks had appeared prompting a meeting of the contractor and the engineer to discuss how to resolve the problems. The homebuyers admitted that they were aware of the meeting and the movement of soil as of October 1997. Between 1998 and 2002, there were more meetings concerning the repair of the foundation, and the homebuyers later testified that they believed that some or all of the parties involved in the design and construction of the foundation would pay for the repairs. At a meeting on January 23, 2002, the homebuyers discovered that there was no party willing to pay for the repairs, and the homebuyers filed suit 5 days later. The defendants moved for and secured summary judgment based on the passing of the statute of limitations.

The court first reviewed the discovery rule:

The discovery rule is a limited exception to the statute of limitations. Computer

> Assocs. Int'l, Inc. v. Altai, Inc., 918 S.W.2d 453, 455 (Tex.1996). The discovery rule is applied when the nature of the injury is inherently undiscoverable. *Id*. at 456. Thus, the discovery rule should be applied only when "it is difficult for the injured party to learn of the negligent act or omission." *Id*. A cause of action accrues when the plaintiff knew or should have known of the wrongful injury. KPMG Peat Marwick, 988 S.W.2d at 749-50. A plaintiff need not know the full extent of the injury before limitations begins to run. Murphy v. Campbell, 964 S.W.2d 265, 273 (Tex.1997).

Id. at **2. The court noted that the Texas Supreme Court had analyzed the discovery rule and determined that:

> the discovery rule does not linger until a claimant learns of actual causes and possible cures. Instead, it tolls limitations only until a claimant learns of a wrongful injury. Thereafter, the limitations clock is running, even if the claimant does not yet know:
>
> · the specific cause of the injury;
>
> · the party responsible for it;
>
> · the full extent of it; or
>
> · the chances of avoiding it.

Id. at **3 (quoting PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P'ship, 146 S.W.3d 79, 93-94 (Tex.2004)) (footnotes omitted).

The court determined that the homebuyers knew of foundation movement and problems in October 1997, and held that the statute of limitation began to run at that point. *Id*.

The homebuyers contended that they had raised fact issues as to whether the defendants were

equitably estopped from asserting limitations since defendants' conduct induced the homebuyers to believe that defendants would pay for any necessary repairs to the home's foundation. The court recounted the elements of the doctrine of equitable estoppel:

> (1) a false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; (5) who detrimentally relies on the representations. Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc., 962 S.W.2d 507, 515-16 (Tex.1998). Estoppel in avoidance of limitations may be invoked in two ways: either a potential defendant conceals facts that are necessary for the plaintiff to know he has a cause of action or the defendant engages in conduct that induces the plaintiff to forego a timely suit regarding a cause of action that the plaintiff knew existed. Rendon v. Roman Catholic Diocese of Amarillo, 60 S.W.3d 389, 391 (Tex.App.-Amarillo 2001, pet. denied).

The court stated that for the homebuyers to raise a fact issue on their estoppel by conduct claim they must have presented some evidence that the defendants' conduct affirmatively induced they into delaying suit beyond the limitations period, unmixed with any want of diligence on their part. *Id*. at **4. The court noted that a plaintiff may not "blindly rel[y] upon a situation as being what it seemed rather than as being what it in reality was." Leonard v. Eskew, 731 S.W.2d 124, 129 (Tex.App.-Austin 1987, writ ref'd n.r.e.) (op. on reh'g). The court found that although there may have been an agreement among the defendants to undertake or pay for some repairs to the residence, there was not evidence that the homebuyers were personally aware of any specific payments from the defendants or that they were aware of any specific agreement among the defendants to pay for

foundation repair to the home.

The court noted that an unsuccessful effort to make repairs does not toll the statute of limitations for purposes of determining when a cause of action accrued. (Citing, *Pako Corp. v. Thomas*, 855 S.W.2d 215, 219 (Tex.App.-Tyler 1993, no writ); and *Muss v. Mercedes-Benz of N. Am., Inc.*, 734 S.W.2d 155, 159-60 (Tex.App.-Dallas 1987, writ ref'd n.r.e.) (applying same rule to equitable estoppel case, but relying on case analyzing when cause of action accrued)).

The court declared that it had not found any cases in which the mere making of repairs, without more, estopped a defendant from asserting limitations. See, e.g., *Gibson v. John D. Campbell & Co.*, 624 S.W.2d 728, 730, 732-33 (Tex.App.-Fort Worth 1981, no writ) (holding that builder was estopped from asserting limitations when builder made initial repair to home and assured homeowner problem was repaired and, after homeowner discovered foundation problems, repeatedly assured homeowner that repairs would be made, sent agent to home to take out ruined carpet and floorboards, and offered to pay for forty percent of cost of replacement carpet). The court stated that it believed such a rule would discourage parties providing goods and services from extending warranties and attempting to repair minor problems without first conducting an extensive investigation to determine liability. As a result, the court concluded that defendants' attempts to make initial repairs to the residence did not raise a fact issue as to equitable estoppel.

The court stated that absent fraud or bad faith, statements made during settlement negotiations do not waive a defendant's right to assert limitations. Compare *Lockard v. Deitch*, 855 S.W.2d 104, 105-06 (Tex.App.-Corpus Christi 1993, no writ) (holding statement in letter from defendant's insurance carrier to plaintiff stating, "Once you have the final specials and medical reports to submit to us for evaluation, we will try to work towards a settlement with you," did not

raise fact issue on plaintiff's equitable estoppel claim) with *Frank v. Bradshaw*, 920 S.W.2d 699, 702-03 (Tex.App.-Houston [1st Dist.] 1996, no writ) (holding that insurance adjuster's statement to plaintiffs that if they sent him their bills, he would pay them, raised a fact issue as to whether defendant was estopped from asserting limitations). The court stated that defendants' seeking insurance coverage was not conduct that could have reasonably induced the homebuyers into delaying suit. On the contrary, the court observed that such conduct should have alerted the homebuyers that defendants thought the homebuyers' claims were actionable.

Without evidence to support their equitable estoppel theory, the homebuyers were unable to reverse the summary judgment against them for allowing the defendants to take years to discuss repairs to the home's foundation. *Id*. at **7.

G. Payment Bond Claims

The payment bond or "Property Code Payment Bond" (also called "Statutory Bond") is a payment bond posted by an original contractor (i.e., a contractor with a direct contract with the owner) which meets the requirements listed in the next paragraph. Bonds posted by subcontractors are not Property Code payment bonds. When a valid Property Code payment bond has been filed, subcontractors and suppliers cannot foreclose liens against the Project, or file suits against the owner, but must look to the bond as their security in case the contractor does not pay.

1. Requirements for a Property Code Payment Bond

The requirements for a valid Texas Property Code bond follow:

- ☞ The bond must be issued by a bonding company authorized and admitted to execute bonds in Texas.

- ☞ The "penal sum" of the payment bond must at least match the amount of the original contract price between the original contractor and the owner.
- ☞ The bond must be signed by both the original contractor and the bonding company.
- ☞ The bond must be conditioned on (i.e., guarantees) prompt payment for all labor and materials used on the project and payment for normal extras, not to exceed 15% of the contract price.
- ☞ The owner must endorse the bond with its written approval.
- ☞ The bond must be filed, together with a copy of the written original contract or memorandum of the contract, with the county clerk of the county in which the project is located.

2. Claims Against Property Code Payment Bond

The best way to perfect a claim against a Property Code payment bond is to follow all the requirements for filing a lien against the project. An alternate method for perfecting a claim against a Property Code payment bond is to provide the bonding company with the notices otherwise required for the owner to perfect a lien against the owner's property. Note the distinction here is that the notices which normally are to be given to the owner, must instead be given to the bonding company.

3. Claims on Non-Property Code Payment Bonds

Not all payment bonds qualify as Property Code bonds. For example, all payment bonds furnished by someone other than an original contractor (i.e., subcontractors) do not meet Property

Code requirements. Because of the unlimited variety of terms which may be included in non-Property Code payment bonds, a claimant must take great care in dealing with these bonds. The claimant should obtain and read the original contractor's or subcontractor's payment bond, as payment bonds may have terms which are more lenient or more strict than the Property Code bond, and may or may not allow recovery where recovery would be available on a Property Code bond.

II. DRAFT AIRTIGHT CONSTRUCTION CONTRACTS

A. What "No Lien" Provisions Mean to a Contract

Parties under Texas law are generally free to form their own contracts granting or releasing such rights as they wish. Although there are a few exceptions, waiving a prospective mechanic's lien is not one of them. Texas law allows a contractor to expressly waive its right to a mechanic's lien either before or after the lien arises, but only if the intent to waive is clear. If the purported waiver is not clearly intentional, it will not be an effective waiver. *Barker & Bratton Steel Works, Inc. v. North River Insurance Co.*, 541 S.W.2d 294 (Tex.Civ.App. -- Dallas 1976, writ ref'd n.r.e.). The law presumes that no intentional waiver has occurred. *Shirley-Self Motor Co. v. Simpson*, 195 S.W.2d 951 (Tex.Civ.App. -- Fort Worth 1946, no writ).

A potential mechanic's lien claimant may validly sign a contract which contains a blanket waiver of lien. If a blanket lien waiver is signed, the claimant cannot assert a lien for labor or materials on a construction project. Once waived, a mechanic's lien cannot be revived. *Collinsville Manufacturing Co. v. Street*, 196 S.W. 284 (Tex.Civ.App. -- Amarillo 1917, no writ).

Sample operative language for a blanket waiver of an original contractor's mechanic's lien rights follows:

> [Original Contractor] for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, hereby waives and releases all liens and claims to liens that the undersigned may now have, or hereafter be entitled to have, from the furnishing of services, labor or materials, whether such liens or claims of lien arise under the Texas Constitution, the Texas Property Code, or otherwise.

Blanket waivers are strictly construed. If a provision may be construed for a legitimate purpose other than a waiver, the provision will be construed to effectuate that purpose and not as a waiver. For example, a contractor may agree with an owner to satisfy every claim for material and labor and to hold the owner harmless from all liens in respect thereto. This provision should be construed merely as a provision which protects the owner from having to pay more than the contract price, and not as a waiver of lien rights. *Childress v. Smith*, 37 S.W. 1076 (Tex.Civ.App. 1896), *rev'd on other grounds*, 40 S.W. 389 (Tex. 1897).

If a contractor agrees not to file a mechanic's lien for a certain period of time, and the time extends beyond the deadline for perfecting the lien, the contractor has effectively waived its lien rights. *Dyer v. Mettalic Building Co.*, 410 S.W.2d 56 (Tex.Civ.App. -- Tyler 1966, no writ).

B. Can You Rely on "Pay-When-Paid" and "Pay-If-Paid" Clauses?

Under Texas law, the parties are free to contract as to when or even if they will receive payment for construction work. The original contractor typically agrees to pay its subcontractors a certain number of days after the original contractor receives payment from the owner. If the subcontract says nothing more, this provision will be interpreted as merely a timing mechanism for

payment, not a shifting of risk of non-payment. The subcontractor will be entitled to payment within a reasonable time whether or not the original contractor is paid for the subcontractor's work. This shifting of the time for payment is known as a "pay when paid" clause.

If, on the other hand, the subcontract additionally states that the owner's prior payment to the original contractor for the subcontractor's work is a condition precedent to the original contractor having to pay the subcontractor, and that the subcontractor assumes the risk of non-payment by the owner, then the original contractor need not pay the subcontractor without prior payment by the owner. The condition precedent of owner payment must occur first before the original contractor is obligated to pay the subcontractor. This shifting of risk of non-payment is known as a "pay if paid"clause.

When a subcontractor agrees to sign a "pay if paid" subcontract, the subcontractor usually anticipates that the subcontractor will not be paid if the subcontractor's work is deficient, and the original contractor is not paid. However, there may be various reasons why the original contractor is not paid, reasons which have nothing to do with deficiencies in the subcontractor's work, or even the subcontractor's work. The owner may not pay the original contractor because the work in some other area is defective, or the work may be behind schedule, or the owner has sustained some costs or expenses totally unrelated to the subcontractor. If the subcontractor agrees to a "pay if paid" clause, the subcontractor should negotiate an exception for owner non-payment not associated with the subcontractor's work.

C. Know the Dangers When Drafting Contracts

1. Implied Contract Obligations

Courts will not generally make contracts for the parties. However, if the words of the contract provide a basis for implying additional terms or conditions, the court may add such terms and conditions. Before a court will add an additional term or condition, the court will determine from the contract either that (1) the implied term was so clearly contemplated by the parties that they deemed it unnecessary to express it, or (2) it is necessary to imply a term or condition to give effect to the purposes of the contract as a whole.

In construction contracts, there is an implied obligation on the owner not to delay or obstruct the contractor in performing the work to be done. The owner can violate this implied duty by not furnishing the necessary materials, easements, rights of way, or services on a timely basis.

The contractor has an obligation of good and workmanlike performance. This obligation does not require perfect work, just work which is acceptable in the industry and under the circumstances. However, this warranty becomes confused when the contractor blames a poor performance on defects in the plans or specifications. Courts may require an experienced contractor to detect and avoid the defects.

If the contractor is constructing a residence, the contractor will have a warranty of habitability, which means that the structure is liveable. In *Evans v. J. Stiles Inc.*, 689 S.W.2d 399 (Tex. 1985), the Texas Supreme Court held that the builder and seller of a new home impliedly warranted both the workmanship and habitability of the home. In *Gupta v. Ritter Homes Inc.*, 646 S.W.2d 168 (Tex. 1983), the court held that the builder/vendor's implied warranty of both workmanship and habitability extended to a subsequent purchaser of the home.

If the contractor has reason to know of the purpose for which a structure or project is to be built, the contractor may owe an implied duty of fitness for a particular purpose. In other words, the

structure or project must function as intended. This duty is particularly important in a design-build situation, where the design-builder is satisfying the owner's needs for a specific structure or project.

The owner's failure to provide adequate plans and specifications can violate an implied obligation to the contractor. However, Texas courts are mixed on the extent of this duty. The Texas Supreme Court in *Longeran v. San Antonio Loan & Trust Co.*, 101 Tex. 63, 104 S.W. 1061 (1907), clearly held that the owner does not warrant the sufficiency of the plans and specifications and is not liable for any defects in them. Two Houston Court of Appeals cases demonstrate the confusion since then.

In *Emerald Forest Utility District v. Simonson Construction Co.*, 679 S.W.2d 51 (Tex.App. -- Houston [14th Dist.] 1985, writ ref'd n.r.e.), the court cited the *Longeran* case and denied a contractor's claims from defective plans and specifications. A different panel of judges in *Shintech v. Group Constructors Inc.*, 688 S.W.2d 144 (Tex.App. -- Houston [14th Dist.] 1985, no writ), rejected the contention that the contractor always assumed the risk of defective plans and specifications. The *Shintech* court held that when the contract was silent, the owner warranted the sufficiency of the plans and specifications for the project.

There is no implied duty of good faith in performing a contract in Texas. The Texas Supreme Court so held in *English v. Fischer*, 660 S.W.2d 521 (Tex. 1983), where it refused to hold that "in every contract there is an implied covenant that neither party will do anything which injures the right of the other party to receive benefits of the agreement."

The case *City of San Antonio v. Forgy*, 769 S.W.2d 293 (Tex.App. -- San Antonio 1989, writ denied), illustrates the problem with no duty of good faith. There, a metal casing around a water well ruptured, and the contractor had to drill a second well at considerable expense. During discovery

in the ensuing suit, the contractor found out that the City's engineer knew before hand that the casing was undersized and was likely to rupture. Despite the City's prior knowledge that the casing would fail, the court refused to impose a duty of good faith on the City in its dealings with the contractor.

In theory, a contractor or owner may disclaim or limit the effect of an implied warranty. In theory, an express warranty should displace an implied warranty. In *Vaughn Building Corp. v. Austin Co.*, 620 S.W.2d 678 (Tex.Civ.App. -- Dallas 1981), *aff'd*, 643 S.W.2d 113 (Tex. 1982), a roofer contended that its one year express warranty demonstrated that the parties intended to displace any implied warranties. The court of appeals held, however, that to disclaim an implied warranty, the parties must expressly state that an express warranty does so. The Supreme Court affirmed the case on interpretation of the express warranty, but did not reach the question of whether the mere existence of an express warranty replaces an implied warranty.

The Texas Supreme Court in *Melody Homes Manufacturing Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987), held that the parties may not waive or disclaim an implied warranty to perform repairs in a good and workmanlike manner. The Texas Deceptive Trade Practices --Consumer Protection Act ("DTPA"), Texas Business and Commerce Code Sections 17.41, et seq., voids most waivers by a consumer of the DTPA's provisions as being contrary to public policy. The DTPA does allow waivers under certain specified circumstances, which involve the retention of legal counsel and large transactions.

2. Differing Site Conditions

Differing site conditions are essentially conditions which differ in some degree from that which the parties expected. One way of managing differing site conditions is to include a differing

site conditions clause in the contract. Differing site conditions clauses seek to allocate equitably an unknown risk between the owner and the contractor. In theory, this equitable apportionment should minimize costs to the owner because it allows the contractor to remove this contingency from its bid. The owner avoids overpayment on the majority of projects and is required to pay for differing site conditions only when they occur.

Despite the theory supporting inclusion, there are good reasons not to include a differing site conditions clause in the contract. Those owners who do not often build may not generate the experience sufficient to realize the cost savings of contractor's removal of the differing site conditions risk. An owner who rarely engages in construction may be more concerned with the potential for a catastrophic cost overrun than the incrementally higher construction cost that the differing site conditions clause may cause. Second, some owners, particularly public owners, have limited funds for the construction of a project. Substantially increasing the project budget to accommodate a changed condition may be impractical. Third, placing the risk on the contractor provides the contractor with an incentive to minimize the financial effect of the discovered condition. If the contract has a differing site conditions clause, the contractor may see the changed condition as an opportunity to recoup other losses on the project at the owner's expense. Finally, in a competitive market, empirical evidence indicates that contractors do not quantify the risk of differing site conditions and may undervalue the risk. Under these conditions, elimination of the differing site conditions clause benefits the owner at little or no cost.

Federal Government contracts contain a standard provision relating to differing site conditions, which takes precedence over any contrary language in the contract. These standard provisions are often included in federally funded work for states and local governments. The federal

provision recognizes two types of differing site conditions. A Type I claim provides for an equitable adjustment if the conditions encountered differ materially from those indicated in the contract. Although the representation of the conditions need not be explicit, the contract documents must provide sufficient grounds to justify a bidder's expectation of latent conditions materially different from those actually encountered.

When the contract documents do not contain affirmative misrepresentations as to anticipated conditions, a contractor's right to a contract adjustment may nonetheless arise from unusual physical conditions differing materially from those ordinarily encountered in work of the character provided in the contract. These claims are generally referred to as Type II claims.

The federal differing site conditions clause is listed in the Code of Federal Regulations, 48 C.F.R. §52.236-2 (1991), as follows:

> (a) The Contractor shall promptly, and before such conditions are disturbed, give a written notice to the Contracting Officer of: (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or (2) unknown physical conditions at the site of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in this contract.
>
> (b) The Contracting Officer shall investigate the site conditions promptly after receiving the written notice. If the conditions do materially so differ and cause an increase or decrease in the Contractor's cost of, or of the time required for, performing any part of the work under this contract, whether or not changed as a

result of the conditions, an equitable adjustment shall be made under this clause and the contract modified in writing accordingly.

(c) No request by the Contractor for an equitable adjustment to the contract under this clause shall be allowed unless the Contractor has given the written notice required; provided, however, the time prescribed in (a) above for giving written notice may be extended by the Contracting Officer.

(d) No request by the Contractor for an equitable adjustment to the contract for differing site conditions shall be allowed if made after final payment under this contract.

The 1987 edition of the American Institute of Architects (AIA) Document A201, General Conditions for the Contract for Construction, contains a differing site conditions clause similar to the federal model.

Having a differing site conditions clause in the contract does not exempt the contractor from inspecting the site. Courts have found an implied obligation that a contractor make at least a minimal inspection of the site to familiarize itself with the property. Most contracts today include an express "site inspection clause" obligating the contractor to inspect and familiarize itself with the conditions at the site. The AIA A201 General Conditions has such an inspection provision, and directs the contractor to verify field conditions and measurements before commencing construction.

When the contract has a site inspection clause, and the contractor unreasonably fails to

inspect the site, the contractor may be foreclosed from invoking the terms of the differing site conditions clause. If, however, the contractor makes a reasonable inspection of the site, yet fails to discover the differing site condition, the two clauses may conflict.

The courts have resolved the conflict by applying a standard of reasonableness. The contractor is obligated to discover conditions apparent through a reasonable investigation. The contractor is not obligated to discover hidden conditions, which do not surface through a reasonable investigation. The contractor is also not required to perform burdensome, extensive, or detailed tests or analyses. If the investigation is constrained by weather conditions, site conditions, or time in the contracting process, the contractor will be only required to perform an investigation that is reasonable under the circumstances.

A disclaimer or reliance clause may limit the effectiveness of a differing site conditions clause. These clauses typically state that information received from the project owner is provided solely for informational purposes and that the owner does not warrant the accuracy or sufficiency of the information provided. The objective of the provision is to render unreasonable any reliance by the contractor on owner-provided information which characterizes the condition of the property.

Courts have reached a variety of results on the effect of disclaimer provisions. Some courts have held that a disclaimer effectively precluded a contractor from arguing that reliance on the owner-provided information was reasonable. See, *J.E. Brenneman Co. v. Commonwealth Department of Transportation*, 56 Pa. 210, 424 A.2d 592 (1981); *Zurn Engineers v. State of California*, 69 Cal.App.3d 798, 138 Cal.Rptr. 478, *cert. denied*, 434 U.S. 985 (1977). In order to be effective, such clauses should provide that the information was not warranted and that the contractor has not relied on the information. These provisions are most effective when combined

with a site inspection clause.

In *Brown-McKee, Inc. v. Western Beep, Inc.*, 538 S.W.2d 840 (Tex.Civ.App. -- Amarillo 1976, writ ref'd n.r.e.), the contractor had no notice of a hard rock formation immediately below the ground surface. However, the contractor's claim for a differing site condition was denied due to a broad disclaimer of subsurface conditions in the contract. The court held that with that clause, the contractor would have to prove deception or bad faith on the part of the owner or show that the owner had withheld material information that it had a duty to disclose.

In *Millgard Corp. V. McKee/Mays*, 49 F.3d 1070 (5th Cir. 1995), the contract disclaimed a particular soil borings report. Although the contract also contained a differing site conditions provision, the court held that the subcontractor could not rely on the soil borings report to support its claim since the report had been specifically disclaimed.

Other courts have held that disclaimer clauses do not preclude reliance on information received from the owner. The situations in which courts have allowed contractors to rely on information received from the owner despite a disclaimer clause may be grouped in three categories. First, cases hold that reliance was permissible because the contractor performed a reasonable investigation that confirmed or supported the information received from the owner. Second, cases hold that reliance was justified because the owner intended that the contractor rely on the information in preparing a bid. Third, cases hold that reliance was justified because the circumstances did not allow sufficient time for the contractor to conduct an adequate independent investigation. The cumulative effect of these limitations is that a contractor may rely on information received from the owner except when relatively simple inquiries might have revealed contrary conditions.

3. Exculpatory Clauses

(A). Indemnity

If the owner requires indemnity for its own negligent acts, the owner cannot subtly demand it. Indemnity for one's own negligence must be expressly stated in the contract. In *Ethyl Corp. v. Daniel Construction Co.*, 725 S.W.2d 705 (Tex. 1987), the Texas Supreme Court announced the express negligence doctrine to avoid confusion in the interpretation and enforcement of indemnity provisions. Unless the owner writes the indemnity provision in clear black and white language, the contractor will not have to indemnify the owner for the owner's own negligence.

The standard AIA language like ¶3.18 in the A201 General Conditions will not satisfy the express negligence doctrine, since it does not mention the owner's negligence.

In *Atlantic Richfield Co. v. Petroleum Personnel, Inc.*, 768 S.W.2d 724 (Tex. 1989), the Texas Supreme Court upheld the following language as satisfying the express negligence doctrine:

> Contractor [PPI] agrees to hold harmless and unconditionally indemnify COMPANY [ARCO] against and for all liability, cost, expenses, claims and damages which [ARCO] may at any time suffer or sustain or become liable for any reason of any accidents, damages or injuries either to the persons or property or both, of [PPI], or of the workmen of either party, or of any other parties, or to the property of [ARCO], in any matter arising from the work performed hereunder, including but not limited to any negligent act or omission of [ARCO], its officers, agents or employees.

In *Dresser Industries v. Page Petroleum Co.*, 853 S.W.2d 505 (Tex. 1993), the Supreme Court stressed that an indemnity agreement must be conspicuous enough to provide "fair notice" of

its term. To provide "fair notice," an indemnity provision must be apparent to a reasonable person. A notation on the face of the contract which draws attention to the provision, such as all capital letters or contrasting type or color is sufficient.

In *Fisk Electric Co. v. Constructors & Associates*, 888 S.W.2d 813 (Tex. 1994), the court held that if an indemnity provision does not initially satisfy the express negligence doctrine, an indemnitor has no duty to indemnify another for their attorney's fees even if the other were later found not to be negligent.

The Texas Civil Practice & Remedies Code §130.002 invalidates a provision which attempts to have a contractor indemnify an architect or engineer for liability and damage for personal injury, property damage, and expenses arising from the design professional's negligence in preparing plans or specifications or in contract administration.

If the owner has required the contractor to indemnify the owner for the owner's own negligence, the contractor should secure sufficient liability insurance to cover the risk. If the contractor cannot obtain such insurance, the contractor should seriously consider qualifying its bid or not bidding at all. A Texas court has held that an agreement to cover a party's negligence also covers the party's gross negligence, which could result in punitive damage award in millions of dollars.

(B). No Damages for Delay

Ordinarily, Owner is responsible for delays the owner causes to the contractor. For example, the owner may be responsible for obtaining rights of way on a project. If the owner does not obtain the rights of way in a timely manner and delays the work, the owner can be liable for the contractor's

extra costs.

In *Anderson Development Corp. v. Coastal States Gathering Co.*, 543 S.W.2d 402 (Tex.Civ.App. -- Houston [14th Dist.] 1976, writ ref'd n.r.e.), the owner was to obtain the rights of way for the work. The parties had planned to do the work in the dry summer months. Because the owner failed to obtain the rights of way before the summer, the contractor had to perform the work in the fall in between rain storms. As a result, the work was performed sporadically as weather permitted and cost significantly more. The contractor did not complete work until three months after the scheduled completion date. The contractor successfully sued to recover its extra costs.

In *Board of Regents of the University of Texas v. S&G Construction Co.*, 529 S.W.2d 90 (Tex.Civ.App. -- Austin 1975, writ ref'd n.r.e.), the owner failed to provide proper plans and specifications. The work was delayed while the job was redesigned on a daily basis. The contractor incurred almost $900,000 in extra costs as a result of the massive number of changes. The contractor successfully sued to recover the extra money. The court reasoned that the owner had caused the delays and increased the costs, and should pay for them.

With a no damages for delay clause, however, the owner can disclaim responsibility for the contractor's extra costs arising from delays on project. Texas courts have upheld the no damages for delay disclaimer.

In *City of Houston v. RF Ball Construction Co.*, 570 S.W.2d 75 (Tex.Civ.App. -- Houston [14th Dist.] 1978, writ ref'd n.r.e.), the contractor received several hundred change orders and almost 900 design clarifications radically altering the plans and specifications for the project. The large number of changes was later held not to be within the contemplation of the parties when the project began. As a result of all the changes, the contractor incurred $3 million in extra cost not including

the direct costs of performing all the extra work. The contractor sued to recover the indirect costs of delay, disruption, general hindrance, and inefficiency.

However, the contract contained a variation of the no damages for delay clause, which precluded recovery for extra indirect costs for changes and modifications to the contract.

There are exceptions to enforcement of the no damages for delay clause. In general, the no damages for delay clause will not be enforced if the delays that occurred were not contemplated when the contract was signed. The contractor's delay claim will not be barred if the delays were caused by the owner's active interference, bad faith, or intentional misconduct. If the owner abandons the contract, the owner can be liable for delay damages regardless of the no damages for delay clause. Finally, if the owner materially misrepresents site conditions or conceals material site conditions information, the owner may be liable for delays the contractor sustains.

(C). Disclaimers of Liability

Disclaimers of liability may come in many flavors. One example is the no damages for delay clause discussed above. The owner may disclaim liability for defects in the plans or specifications, or for the availability of materials. The owner may disclaim liability for extra costs that the contractor incurs for any of a variety of specified reasons. For example, the owner may require the contractor to assume the risk that regulatory authorities may change regulations on the handling of aspects of the work, with the owner disclaiming any responsibility for the extra costs of such changes.

The parties may disclaim liability for special, incidental, indirect and consequential damages arising from some cause or other or from a breach in the contract. To demonstrate, say the owner

agrees to pay the contractor $1 million for the project. The contractor then buys an expensive machine for the project. The owner does not pay on schedule. Without the payment, the contractor cannot make payments on the equipment and the bank repossesses it. The loss of the equipment is a special or consequential damage. If the owner disclaims special or consequential damages, the contractor will have no claim against the owner for loss of the equipment.

(D). Limitations of Liability

The assumption of risk should have a value. For example, to limit risk, a party may buy insurance. The value of that risk then becomes the cost of the insurance. To avoid the high costs of risk, the parties may agree to a method of limiting liability.

(1) Liability Limited to Amount of Compensation

One method of limiting liability is to cap a party's liability to a set amount or a percentage of some amount. For example, the parties may agree to limit the liability of the contractor to the amount of its contractor's fee for the project. This will allow the contractor to quantify the risk of liability to the owner, and to remove a contingency for the liability from its price. In theory, the owner then receives the benefit of a lower price in return for a definable value of liability for the contractor.

(2) Liability Limited to Insurance Proceeds

An alternative way of limiting liability is to limit the liability to the amount of insurance proceeds. Risk has a cost. Purchasing insurance allocates the cost and defines the amount of risk. Again, the owner may receive a lower price, as the contractor deletes a contingency for the risk now covered by insurance. If the owner protests the amount of insurance is too low, the contractor can

ask the owner to set the amount of insurance at a higher figure, with the contractor passing along to the owner the cost of the higher insurance.

(3) Liability Limited to a Set Amount

Another way to define the risk is to limit the amount of liability to a set amount, which may be more or less than the contractor's fee. Here, the parties agree that in the event of a claim by the owner against the contractor, the contractor's liability is limited to $10,000, or some other agreeable figure. Again, the advantage is that the risk is defined and may be deleted as a contingency, saving costs for both parties.

(4) Limitation of Liability on a Comparative Negligence Basis

The parties may agree to limit liability to the percentage fault that one party bears for the problem. For example, the contractor may limit its liability to the owner to the percentage share that the contractor's negligence or fault bears to the total negligence of the owner, other contractors, the architect/engineer, and all other negligent parties. This limitation in the contract tends to reduce the owner's expectations of recovery from the contractor and may lead to an earlier resolution or settlement of the dispute.

D. Review Essential Elements of Sample Mechanic's Lien Forms

Chapter 53 of the Property Code is the Texas statute that governs improvements to privately owned real estate. The following discussion will cover the procedures for obtaining a lien, making a claim on a payment bond and making a claim under the "trust fund" statute.

1. Original Contractor's Liens:

(A). Constitutional Lien: The Texas Constitution provides for a lien. A constitutional lien is available only to those who have a contract with the owner. It protects prime or "original contractors", as they are referred to in the Property Code, but not subcontractors.

(B). Perfection of Constitutional Lien: A contractor does not have to comply with the notice provisions of the Property Code to enforce the lien against the owner. For the contractor to be protected against the rights of third parties, such as subsequent purchasers of the property, the contractor must see that the third party has notice of the lien. This may be accomplished by filing a lien affidavit (See Private Form #6).

(C). Original Contractor's Property Code Lien: In order to perfect a lien under the Property Code, an original contractor must file a lien affidavit not later than the 15th day of the fourth month following the month in which the original contract has been: a) materially breached and thus terminated by the contractor or by the owner; b) completed; c) finally settled; or d) abandoned. The original contractor must also within 10 days after filing the lien affidavit send to the owner by certified or registered mail, addressed to the owner's last known business or residence address, a copy of the affidavit claiming lien.

(D). Definition of "Original Contractor": An original contractor is one who has a direct relationship with the owner, either directly or through the owner's agent. A subcontractor has no contract with the owner, but may have a contract with, and may furnish the labor or material to an original contractor or to another subcontractor. The difference between an original contractor and a subcontractor is significant. An original contractor has very simple notice procedures. A subcontractor, whether first or second tier, has additional notice requirements. In addition, a subcontractor's lien only secures payment of funds trapped in the hands of the owner or retainage

funds which the owner is required to keep by law.

2. Suppliers' and Subcontractors' Property Code Lien and Bond Claims:

Generally, a subcontractor or supplier, is dealing with one of the following situations:

a. There is no payment bond since bonds on private construction projects in Texas are optional. In this situation you only have your rights to a lien to secure payment of the "trapped funds" and/or the "10% statutory retainage fund".

b. The original contractor may have given the owner a payment bond. In this situation you can perfect a claim against the bond by giving the appropriate notices and/or by filing a perfected lien.

c. The subcontractor/supplier is dealing with another subcontractor who has provided a payment bond. In this situation you have lien rights against "trapped funds" or "statutory retainage" and a claim against the subcontractor's payment bond, and possibly a claim against the original contractor's bond.

The safe course of action is always to file notices and a lien in accordance with the requirements of the Property Code. Safer yet is to perfect and file a lien, and to furnish copies of the lien affidavit and notice letters to the payment bond surety, if there is one, by certified mail.

3. Trapping Funds Due Under Prime Contract (Unbonded Projects):

The legal effect of a timely and proper notice of claim by a subcontractor or supplier to the owner is to "trap" funds due the original contractor in the hands of the owner. It is essential that a claimant "trap funds" because unless funds are trapped in the hands of the owner, the claimant's

recovery under its lien is limited to his share, if any, of the original contractor's 10% statutory retainage being withheld by the owner. It is to a claimant's advantage to send notices to the owner as soon as a payment problem is evident. In addition, the claimant should send a written demand for payment (Private Form #5) to the owner and the prime contractor.

4. Statutory Retainage Fund (Unbonded Projects):

During the progress of work under the original contract and for 30 days after that work is completed, the owner of an unbonded project is required to retain either 10% of the amount of each original contract or 10% of the value of the work, measured by the proportion that the work done bears to the work to be done, using the contract price or, if there is no contract price, using the reasonable value of the completed work. This retainage fund is for the benefit of claimants who have filed lien affidavits within 30 days after completion of the original contract and who have sent required notices. The 10% retainage requirement does not apply if there is a payment bond.

4. Requirements for Subcontractors and Suppliers:

(A.1) (a) Claimants contracting with an original contractor:

(a) OPTIONAL RETAINAGE ONLY NOTICE - for all persons contracting with the original contractor to furnish material, labor and/or specially fabricated material, a notice may be sent to the owner not later than the 15th day of the second month following first delivery of materials or the performance of labor after the agreement was made (see Private Form #1). Any claimant who fails to provide the optional retainage notice must provide notice to the owner of each month's retention billed but

unpaid within the time requirements described in Paragraph E.l(c) below.

(A.1) (b) Additional Notice for Specially Fabricated Material:

(i) To perfect a claim for specially fabricated items, the claimant must send a notice to the owner (and to the original contractor if dealing with a subcontractor or another supplier) not later than the 15th day of the second month following the month in which the order was received and accepted (see Private Form #2); and

(ii) When material is delivered, give notice described in Paragraph E.l(c) below (Private Form #4).

(A.1) (c) Notice for Labor and Materials Delivered - including specially fabricated materials and retainage if optional retainage notice not given. Notice to owner (Private Form #4) and original contractor not later than the 15th day of the third month following each month during which labor or materials were furnished (DATE OF DELIVERY CONTROLS - NOT DATE OF INVOICE).

WARNING: If original contract is nearing completion, do not wait the full number of days as there may be no funds to "trap" in the owner's hands to insure your claim can be paid. To be safe, notice to the owner should be given no later than 30 days after completion of the original contract.

(A.1) (d) Filing Lien Affidavit (Private Form #6):

(i) You must file not later than the 15th day of the fourth month following the last month in which you provided labor or material; or

(ii) If claim is for specially fabricated materials, the lien affidavit must be filed by the 15th day of the fourth month from the earliest of (i) the last month the material was delivered; or (ii) the last month material would normally have been required; or

(iii) For a portion of the statutory retainage held by the owner, within 30 days after completion of the original contract.

(iv) After you have filed the Affidavit with the county clerk of the county in which the project is located, you must send copies of the Affidavit by registered or certified mail to the owner and original contractor, at their last known business or residence address, within 10 days after filing.

WARNING: The safest practice is to be sure that the lien affidavit is filed no later than 30 days after completion of the original contract.

(A.2). Claimant's contract is with a subcontractor or a supplier:

(A.2) (a) Optional Retainage Only Notice - applicable to all persons contracting with a subcontractor or a supplier to furnish material, labor and/or specially fabricated material:

A notice may be sent to the owner and original contractor not later than the 15th day of the second month following the month of first delivery of materials or labor under the agreement providing for retainage. (see Private Form #1). Any claimant who

fails to provide the optional retainage notice must provide notice to the original contractor and/or owner of each month's retention billed but unpaid within the time requirements described in Paragraph E.2(c) below.

(A.2) (b) For Undelivered Specially Fabricated Materials:

(i) Notice to owner and original contractor not later than the 15th day of the second month following the month in which the order was received and accepted. (Private Form #2).

(ii) When material is delivered, give notice described in Paragraph E.2(c) below.

(A.2) (c) For Labor and Materials Delivered - including specially fabricated materials and retainage if optional notice not given.

(i) Notice to original contractor (Private Form #3) not later than the 15th day of the second month following each month during which labor or materials were furnished; AND

(ii) Notice (Private Form #4) to owner and original contractor not later than the 15th day of the third month following each month during which labor and materials were furnished.

(A.2) (d) Filing Lien Affidavit (Private Form #6):

(i) You must file not later than the 15th day of the fourth month following the last month during which labor was performed or material was furnished; or

(ii) If claim is for specially fabricated materials, file by the earliest date of (i) last month material delivered; or (ii) last month material would normally have been required; or

(iii) If the original contract has been breached or terminated by the owner or prime contractor, or if the party with whom you contract commits a breach or terminates your sub-contract, file based on the date of the breach or termination.

(iv) If claim is for a portion of the statutory retainage, file within 30 days after completion of the original contract.

(v) After you have filed the Affidavit with the county clerk of the county in which the property is located (53.052(a)), you must send copies of the Affidavit by registered or certified mail to the owner's and original contractor's last known business or residence address. This notice has to be sent within 10 days after filing the Affidavit.

WARNING: The safest practice is to be sure that the lien affidavit is filed no later than 30 days after completion of the original contract.

(A.3) Enforcement:

To enforce your lien claim you must file suit within two years after the date of filing your affidavit claiming lien or within one year after completion of the prime/original contract, whichever

is later. These time limits are strict and for a claim against a bond they are even shorter, see H.3 of this book.

5. How to Obtain Information:

In order to properly notify the Owner and Original Contractor, and in order to properly file a lien, various items of information must be available to a claimant. The Property Code has a provision to make this process easier. The Property Code allows a claimant to obtain, among other things; (1) a legal description of the property from the owner; (2) a copy of any bond furnished to the Owner or furnished to the Original Contractor or to any Subcontractor; (3) information on whether there is prior liens filed on the property; and (4) the name and address of the Owner (Private Forms 7 through 9). You may be charged up to $25 for asking for this information from a person with whom you do not have a contract, but if the information is not provided to you, you may recover your reasonable and necessary costs incurred in obtaining the information requested.

6. "Trust Fund" Claim:

Subchapter 162A. of the Property Code can provide a claimant with a means of recovery even where the claimant has failed to properly perfect a lien claim. The following are the significant aspects of the trust fund statute:

(A). Personal Liability:

Where a contractor or subcontractor is paid, but fails to pay his subcontractor or supplier, the contractor or subcontractor, and its agents, officers, directors or the persons who directed or

controlled the use of the monies received which were diverted to another project or use, may be held personally liable for the debt.

(B). Criminal Penalties:

The diversion or misapplication of "trust funds" by a contractor, subcontractor, owner or any other officer, etc. is punishable by fine and/or imprisonment.

(C). Lien Unnecessary:

The benefits of the trust fund statute may be claimed regardless of whether or not a lien has been perfected.

(D). Parties Exempted:

Trust fund statute is not applicable to any lender, title company, closing agent, or bonding company.

(E). Defense:

It is a defense under the Trust Fund Statute that the trust funds were used to pay the trustee's "actual expenses directly related to the construction or repair of the improvement".

7. The Property Code Payment Bond:

The payment bond or "Property Code Payment Bond" (also called "Statutory Bond") is a payment bond posted by an original contractor (i.e., a contractor who has a direct contract with the

owner) which meets the requirements set out in the next paragraph. Bonds posted by subcontractors are not Property Code payment bonds. When a valid Property Code payment bond has been filed, subcontractors and suppliers cannot foreclose liens against the Project, or file suits against the owner, but must look to the bond as their security in case the contractor does not pay.

(A). Requirements for a Property Code Payment Bond:

(a) The bond must be issued by a bonding company authorized and admitted to execute bonds in Texas.

(b) The payment bond must be in a "penal sum" i.e., at least in the amount of the original contract price between the original contractor and the owner.

(c) The bond must be signed by both the original contractor and the bonding company.

(d) The bond must be conditioned on (i.e. guarantees) prompt payment for all labor and materials used on the project and payment for normal extras, not to exceed 15% of the contract price.

(e) The owner must endorse the bond with his written approval.

(f) The bond must be filed, together with a copy of the written original contract or memorandum of the contract, with the county clerk of the county in which the project is located.

(B). Claims Against Property Code Payment Bond:

(a) The best way to perfect a claim against a Property Code payment bond is to follow

all requirements for filing a lien against the project.

(b) The alternate method for perfecting a claim against a Property Code payment bond ia to perfect a valid claim by giving the notices which are required for a lien, with the crucial difference that the notices which normally are to be given to the owner, must instead be given to the bonding company in order to perfect a claim against a statutory payment bond.

(C). Enforcement:

The time limits for filing a lawsuit based upon a Property Code payment bond are strict. Suit may not be filed under the Property Code payment bond until 60 days after the claim is perfected. A lawsuit on a bond claim must be brought within 12 months after the claim is perfected.

8. Claims on Non-Property Code Payment Bonds:

An example of payment bonds which do not meet the Property Code requirements are all payment bonds furnished by someone other than a prime contractor. Because of the unlimited variety of terms which may be included in non-Property Code payment bonds, great care must be exercised in dealing with these bonds. It is very important to obtain a copy of any payment bond posted by a prime contractor and/or a subcontractor, as payment bonds may have terms which are more lenient or more strict than the Property Code bond, and may or may not allow recovery where recovery would be available on a Property Code bond.

9. Liens on Residential and Homestead Property:

Residential property is defined under the Property Code as a single family house, duplex, triplex, or quadruplex or a unit in a multiunit structure used for residential purposes. Residential property is given special protection against liens. Homestead property is given even more protection. A mechanic's lien can be attached to residential property, but only if the following requirements are met:

1. The claimant other than an original contractor must give notice to the owner and original contractor of the unpaid balance not later than the 15th day of the second month following each month in which all or part of the claimant's labor was performed or material or specially fabricated material was delivered. The notice must state that if the claim remains unpaid, the owner may be subjected to a lien unless the owner withholds payment from the contractor or the claim is otherwise paid or settled. The notice must be sent by certified or registered mail.

2. If specially fabricated materials have not been delivered to the project or incorporated into the work, the claimant for those materials must give notice to the owner by the 15th day of the second month after the month in which the claimant receives and accepts the order for the material. If the claimant did not contract with the original contractor, the claimant must also give the same notice to the original contractor. Once the specially fabricated materials have been delivered, the claimant must give notice of non-payment by the 15th day of the second month after the delivery of the materials.

Please note that the Property Code requires that the claimant provide certain specified disclosures to the owner about the owner's rights and liabilities. However, the claimant's failure to comply does not invalidate a lien.

3. Homestead Property

In addition to the requirements for perfecting a lien on residential property, to fix a lien on homestead property, the claimant must do the following:

(a) Sign a written agreement, setting out terms of the contract, and containing the "Homestead Warning" with the owner of the homestead property, before work is performed. (See Texas Property Code §53.255 for warning).

(b) If the owner of the homestead is married, both spouses must sign the contract.

(c) The contract must be filed with the clerk of the county in which the homestead is located. The best practice is to have the contract recorded by the county clerk before any work or material is provided under the contract.

(d) Add to the notice of non-payment required for residential property the following specified notice:

"If a subcontractor or supplier who furnishes materials or performs labor for construction of improvements on your property is not paid, your property may be subject to a lien for the unpaid amount if:

"(1) after receiving notice of the unpaid claim from the claimant, you fail to withhold payment to your contractor that is sufficient to cover the unpaid claim until the dispute is resolved; or

"(2) during construction and for 30 days after completion of construction, you fail to retain 10 percent of the contract price or 10 percent of the value of the work performed by your contractor.

"If you have complied with the law regarding the 10 percent retainage and you have withheld payment sufficient to cover any written notice of claim and have paid that

amount, if any, to the claimant, any lien claim filed on your property by a subcontractor or supplier, other than a person who contracted directly with you, will not be a valid lien on your property. In addition, except for the required 10 percent retainage, you are not liable to a subcontractor or supplier for any amount paid to you contractor before you received written notice of the claim."

When this is done, the mechanic's lien on the homestead benefits all the persons who do work or furnish materials on the job. If the Original Contractor fails to comply with these requirements, none of the subcontractors or suppliers will have valid lien claims.

10. Liens on Leasehold Improvements:

Anyone who contracts to provide improvements to a tenant may acquire a lien against the tenant's lease rights, known as the leasehold estate. However, neither the lien against the leasehold estate, nor the contract to do improvements for a tenant gives a contractor any lien rights against the owner of the property. Unless the lien claimant can show that a tenant was acting as the agent of the landlord, in contracting for improvements to the leased property, claimant is usually left without any significant lien rights on leasehold improvements.

11. Private Forms:

The following forms are examples containing the requisite warnings and notices. Please note that each instance of non-payment may be different and require a different legal approach. Please consult your legal advisor for an analysis of your particular fact situation. Suppliers and subcontractors who frequently file notices and liens should consult with their attorneys to have forms prepared for their specific needs.

PROPERTY CODE DEADLINES
(PRIVATE CONTRACTS IN STATE OF TEXAS)

(1) MONTH LABOR PERFORMED OR MATERIALS DELIVERED	(2) LAST DATE FOR EARLY NOTICE TO ORIGINAL/PRIME CONTRACTOR BY CLAIMANT WHO DEALT WITH SUBCONTRACTOR	LAST DATE FOR FUND TRAPPING NOTICE TO OWNER AND ORIGINAL CONTRACTOR OR REGULAR NOTICE TO SURETY ON PROPERTY CODE BOND	(3) LAST DATE FOR FILING LIEN AFFIDAVIT (ASSUMING (1) IS LAST MONTH OF PERFORMANCE OR DELIVERY)
JANUARY	MARCH 15	APRIL 15	MAY 15
FEBRUARY	APRIL 15	MAY 15	JUNE 15
MARCH	MAY 15	JUNE 15	JULY 15
APRIL	JUNE 15	JULY 15	AUGUST 15
MAY	JULY 15	AUGUST 15	SEPTEMBER 15
JUNE	AUGUST 15	SEPTEMBER 15	OCTOBER 15
JULY	SEPTEMBER 15	OCTOBER 15	NOVEMBER 15
AUGUST	OCTOBER 15	NOVEMBER 15	DECEMBER 15
SEPTEMBER	NOVEMBER 15	DECEMBER 15	JANUARY 15
OCTOBER	DECEMBER 15	JANUARY 15	FEBRUARY 15
NOVEMBER	JANUARY 15	FEBRUARY 15	MARCH 15
DECEMBER	FEBRUARY 15	MARCH 15	APRIL 15

(1) IF NOTICE PERTAINS TO SPECIALLY FABRICATED ITEMS THE DATE OF RECEIPT AND ACCEPTANCE OF THE ORDER CONTROLS NOTICE ON UNDELIVERED SPECIALLY FABRICATED ITEMS.

(2) CONTRACTUAL RETAINAGE NOTICE TO OWNER AND/OR PRIME CONTRACTOR DUE.

(3) SUBS AND SUPPLIERS SHOULD ALWAYS REMEMBER TO FILE AFFIDAVIT WITHIN 30 DAYS OF COMPLETION TO TRAP STATUTORY RETAINAGE.

Private Form #l - NOTICE OF RETAINAGE AGREEMENT

(1)
_____

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

Dear Sir:

Our company is pleased to be involved in the construction of your (2) at (3) under an agreement with (4) your (5). Our part of this project will be to furnish the (6) called for by the plans.

Our agreement provides that a portion of the contract price is to be retained until (7).

The amount to be retained is (8).

We are advising you that we have commenced supplying labor or material to your project and of the above terms of our agreement so that you will have the information and notice required by law. If you have any questions, do not hesitate to call us.

Sincerely,
(9)
(10)

cc: (11)

* * * * *

(1) Letter addressed to the owner of the property being improved.

(2) Indicate type of improvement.

(3) Address of job.

(4) Name of firm under whom you are working.

(5) Status of that firm, such as "general contractor," "roofing subcontractor", etc.

(6) Describe the labor and/or material that you will perform.

(7) Insert time for paying retainage.

(8) Amount or percentage of retainage.

(9) Your firm name.

(10) Name and capacity of person signing letter.

(11) Carbon copy to the original contractor by certified mail unless you have a contract directly with the original contractor.

Private Form #2 - NOTICE OF SPECIALLY FABRICATED ITEM

(1)
_____
_____

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

Dear Sir:

Our firm is pleased to be involved in the construction of your (2) at (3) under an agreement with (4) your (5). Our part of this project will be to fabricate and furnish (6) for use as a component part of the construction as called for in the plans. This component will be reasonably unsuitable for use elsewhere. The order for this item has been received and accepted and the price to be billed to our customer is $(7).

We are advising you of the foregoing so that you will have the information and notice specified by law.

If you have any questions, please call us.

Yours very truly,

(8)
(9)

cc: (10)

* * * * *

(1) Letter addressed to the owner of the property being improved.

(2) Indicate type of improvement.

(3) The address of the job, with street and city.

(4) Name of company for whom you work.

(5) Status of the person under whom you are working, such as "general contractor" or "roofing subcontractor", etc.

(6) General description of the item being fabricated.

(7) Contract price for the item being fabricated.

(8) Name of your company.

(9) Person signing letter and capacity.

(10) Carbon copy to original contractor by certified mail unless the order was direct from the original contractor.

Private Form #3 - PRELIMINARY NOTICE TO ORIGINAL CONTRACTOR

(1)

_____

_____

Re: Job: (2)
Owner: (3)
Location: (4)

Dear Sir:

We have furnished (5) on the above job to your subcontractor, (6). Our books show an unpaid balance due us on this job of $(7) through the end of (8).

We are giving you this notice in order to protect our rights under the mechanic's lien laws of Texas.

We wish to cooperate with both you and our customer in any way that would be helpful. Should you desire any additional information, please advise us.

Sincerely,

(9)
(10)

cc: (11)

* * * * *

(1) Letter addressed to the original contractor under whom you are working sent certified mail.

(2) Name of project.

(3) Owner's name.

(4) Address of job--street, city and state.

(5) Indicate generally what has been furnished.

(6) Your customer.

(7) Amount due.

(8) Date of last billing.

(9) Your firm name.

(10) Name and capacity of person signing letter.

(11) Your customer.

Private Form #4 - NOTICE TO OWNER AND ORIGINAL CONTRACTOR

(1)
_____
_____

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

Dear Sir:

We have furnished (2) to (3). (4) on the construction in progress on your property at (5) We have not been paid the amounts due us for the month of (6) in the amount of $ (7) as shown by the attached statement which is made a part hereof. Under the mechanic's lien laws of Texas, a subcontractor or supplier of goods or labor is required to notify the owner of all claims which are not paid. Failure to give this notice may cause us to lose our rights under the mechanic's lien laws if the sums are not finally paid.

The law requires that we advise you that if our bill is not paid, you may be personally liable and your property subjected to a lien unless you withhold payments to the contractor for the payment of our statement or unless the bill is otherwise paid or settled.

Demand is hereby made for the payment of our claim from funds withheld by you as owner unless the contractor disputes this claim as required By law.

Should you have any question concerning our claim, please advise us. We will appreciate being advised if there is a dispute as to our claim from the contractor.

Sincerely,

(9)
(10)

cc: (11) Certified Mail Return Receipt Requested
(12) Certified Mail Return Receipt Requested

* * * * *

(1) Letter addressed to the owner of the property being improved and original contractor.
(2) Indicate generally what has been furnished.
(3) Name of the person to whom you furnished goods or labor.
(4) Indicate status of person to whom you furnish, such as "contractor" or "subcontractor."
(5) Address of the job--street number, and city.
(6) Indicate the month or months during which work was done for which payment has not been received.
(7) The amount due.
(8) If you have already filed a lien affidavit or are doing so simultaneously insert: "We have elected to file an affidavit claiming a lien on your property and enclose a copy of the affidavit as filed."
(9) Your company.
(10) Person signing letter and capacity.
(11) The general contractor, if not your customer.
(12) Your customer.

Private Form #5 - DEMAND FOR PAYMENT

(1)

_____

Dear Sir:

We have furnished (2) to (3), (4) on the construction in progress on your property at (5) . We have not been paid the amounts due us for the month of (6) in the amount of $ (7).

Demand is hereby made for the payment of our claim from funds withheld by you as owner.

Should you have any question concerning our claim or this notice, please advise us. We will appreciate being advised if there is a dispute as to our claim from the contractor.

Sincerely,

(8)
(9)

cc: (10)
(11)

* * * * *

(1) Letter addressed to the owner of the property being improved sent by Certified Mail

(2) Indicate generally what has been furnished.

(3) Name of the person to whom you furnished goods or labor.

(4) Indicate status of the person to whom you furnish, such as "contractor or "subcontractor"

(5) The address of the job, street, number and city.

(6) Indicate the month during which work was done for which payment has not been received.

(7) The amount due.

(8) Your company.

(9) Person signing letter and capacity.

(10) Send carbon copy to general contractor.

(11) Send carbon copy to your customer, if other than the general contractor.

Private Form #6 - AFFIDAVIT CLAIMING LIEN

THE STATE OF TEXAS :

AFFIDAVIT CLAIMING LIEN

COUNTY OF (4) :

BEFORE ME, a notary public in and for the State of Texas, on this day personally appeared the undersigned, who being by me duly sworn, on oath states:

1. My name is (1). I am the (2) of (3) ("Claimant") and am authorized to make this affidavit on its behalf as the sworn statement of its claim.

2. Claimant furnished labor and/or materials for the improvement of the following described land in (4) County, Texas:

(5)

3. The labor and/or material was furnished for such improvement to (6). (7).

4. (8) is the original contractor for such improvement.

5. (9) is the owner or reputed owner of the land and improvements thereon.

6. The kind of work done and/or material furnished by claimant is (10) and is made up of the items shown on the attached Exhibit "A" which reflects the dates of Performance and/or delivery.

7. The amount unpaid for such furnishing and due and owing to claimant is $(11), which is true, correct, and just, with all just and lawful offsets, payments, and credits known to affiant allowed.

8. Claimant's address is (12).

Claimant claims a lien against all the above described land and improvements thereon in the amount shown above pursuant to Chapter 53 of the Texas Property Code, and makes this sworn statement of claim in support thereof.

(3)

By: (1)

Subscribed and sworn to before me by the said (1) this ___ day of _____, 19__, to certify which witness my hand and seal of office.

_____

Notary Public - State of Texas

THE STATE OF TEXAS :

COUNTY OF _____ :

BEFORE ME, the undersigned authority, on this day personally appeared (1), (2) of (3), known to me to be the person and officer whose name is subscribed to the foregoing instrument, who after being by me duly sworn

acknowledged that the statements contained above are true and correct and that he executed the same for the purposes and consideration therein expressed, in the capacity therein stated, and as the act and deed of said (13).

Given under my hand and seal of office this ____ day of _____, 19___.

_____
Notary Public - State of Texas

_____
Typed or Printed Name of Notary Public

My Commission Expires:
_____

* * * * *

(1) Name of the person signing the affidavit.

(2) Position of the affiant with the claimant, such as credit manager, controller, owner, partner, president, etc.

(3) Name of claimant.

(4) County in which the land is located.

(5) Legal description of the land, e.g.:

(a) Lot 1, Block 2, Jones Subdivision of the City of Austin, per plat recorded in Volume ___, Page _____, Plat Records, Travis County, Texas; or

(b) The 50 acres covered by the deed from Frederic N. Freeloader to Horace P. Homeowner, dated _____, recorded in Volume _____, Page _____, Deed Records, Travis County, Texas, which is referred to for a more complete description.

(6) Name of the general contractor or subcontractor for whom work was done or material was furnished. If a subcontractor, add "a subcontractor."

(7) If the work or material was furnished under a written contract, it is preferable to attach the contract and insert, "The labor and/or material was furnished under a written contract which is attached hereto and made a part hereof."

(8) Name of original (general) contractor.

(9) Name of property owner.

(10) General description of work done or materials supplied.

(11) Amount due, including retainage.

(12) Your business address.

(13) e.g., partnership, corporation, etc.

Private Form #7 - REQUEST FOR INFORMATION FROM OWNER

(1), 19___

(2)

_____

_____

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

Re: (3)

We are furnishing labor and/or materials for the above-referenced project. Pursuant to Section 53.159(a) of the Texas Property Code, we request that you provide us with the following information within 10 days after receipt of this request:

(1) A legal description of the real property upon which the above-referenced project is being constructed.

(2) Whether a payment bond has been provided to you on this project, and if so, the name and last known address of the surety and a copy of the bond.

(3) Whether there are any prior recorded liens or security interests on the real property being improved and if so, the name and address of the holder of the lien or security interest.

In the event you fail to furnish the above-requested information, you may be liable for the undersigned's reasonable and necessary costs incurred in procuring the requested information.

Also, we request you furnish our company with a copy of the affidavit of completion, if used, filed with the county clerk for this project. Thank you for your attention to this request.

(4)

By: (5)

* * * * *

(1) Date of request.

(2) Name and address of owner.

(3) Project.

(4) Your Company.

(5) Officer of your Company.

PRIVATE FORM #8
REQUEST FOR INFORMATION FROM ORIGINAL CONTRACTOR

(1), 19____

(2)
_____
_____

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

RE: (3)

We have furnished labor and/or materials for the above-referenced project. Pursuant to Section 53.159(b) of the Texas Property Code, we request that you provide us with the following information within 10 days after receipt of this request:

(1) The name and last known address of the person to whom you furnished labor or materials for the project.

(2) Whether a payment bond has been provided by or to you on this project, and if so, the name and last known address of the surety(s) and a copy of the bond(s).

In the event you fail to furnish the above-requested information, you may be liable for the undersigned's reasonable and necessary costs incurred in procuring the requested information.

(4)

By: (5)

* * * * *

(1) Date of request.

(2) Name and address of original contractor.

(3) Project.

(4) Your company.

(5) Officer of your company.

PRIVATE FORM #9
REQUEST FOR INFORMATION FROM SUBCONTRACTOR

(1), 19___

(2)

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

RE: (3)

The undersigned (4) the above-referenced project. Pursuant to Section 53.159(c) of the Texas Property Code, we request that you provide us with the following information within 10 days after receipt of this request:

(1) The name and last known address of each person from whom you purchased labor or materials for the project, other than those materials which were furnished by you from your own inventory.

(2) The name and last known address of each person to whom you furnished labor or materials for the construction project.

(3) Whether a payment bond has been provided by or to you on this project, and if so, the name and last known address of the surety and a copy of the bond.

In the event you fail to furnish the above-requested information, you may be liable for the undersigned's reasonable and necessary costs incurred in procuring the requested information.

(5)

By: (6)

* * * * *

(1) Date of request.

(2) Name and address of subcontractor.

(3) Project.

(4) Fill in as applicable:
(a) is the owner of
(b) is the original contractor on
(c) is the surety which bonded the original contractor for
(d) has furnished work under your subcontract on.

(5) Your company.

(6) Officer of your company.