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Mechanics Liens and Legislative Changes From HB 2237 Effective January 1, 2022

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Following is an outline of the statutory scheme and recommended best practices for owners and their lenders to avoid incumbrance by mechanics' and materialmens' liens. This outline includes statutory changes out of the Texas Legislature's 2021 Regular Session, specifically HB 2237 (referred to herein as the "Amendment"), which is effective *for construction contracts signed January 1, 2022*. Because the current statute will remain in effect for all contracts entered into prior to January 1, 2022, the current rules under Texas Property Code Chapter 53 will be relevant for some time to come.

This outline does not deal in depth with an original contractor's constitutional lien.¹ The constitutional lien does not require compliance with the requirements of the Texas Property Code to enforce the lien. The Constitutional Lien is only available to original contractors and, for construction purposes, is generally limited to "buildings." As an example, site improvements such as sidewalks and landscaping would not likely be lienable under a constitutional lien. A prime contractor's lien affidavit will usually include a claim for a constitutional lien in case there are issues with enforcement of its statutory lien.

This outline does not deal in depth with special contracting requirements for residential construction, which has additional layers of protection for owners against mechanics liens.² Note that Section 50(a) of Article 16 of the Texas Constitution sets out additional requirements that must be met to incumber homestead improvements in Texas.³

This outline only deals with commercial private development in Texas and does not include any bond claim issues related to State of Texas or Federally funded projects that may be covered by payment bonds required by the Texas Government Code or the Federal Miller Act.

Now, on to the topic at hand. There are a number of things owners and their lenders can do or at least be mindful of to avoid property being subject to mechanics' and materialmens' liens.

¹ Original contractors benefit from a lien provided under the Constitution of the State of Texas. Texas Constitution Article XVI, §37 allows original contractors a lien for construction or repair of "buildings and articles."

² "Residential construction" is now defined in the Property Code, for mechanics' lien purposes as projects of four or fewer residential units where the owners intend to occupy one of the units. If the residential property happens to be a homestead, there are additional requirements, both in the lien and notice provisions and in the form of the contract that the general contractor enters into with the owner. For residential construction, refer to Subchapter K of Chapter 53 of the Texas Property Code, Chapter 42 of the Texas Property Code.

³ 1. The original contractor has a written contract with owner that is signed by both spouses (if owner is married);
2. The contract must be executed at least 5 days after the owner applies for an extension of credit for the work and material (unless the work and material is for immediate repairs that affect health and safety of the residents and the residents confirm the same in writing);
3. The contract for work and material provides that the owner can rescind the contract without penalty or charge within 3 days after the contract is executed (unless the work and material is for immediate repairs, like no. 2); and,
4. The contract for work and material is executed by the owner and owner's spouse only at the office of:
1. A third-party lender making an extension of credit for the work and materials;
2. An attorney; or,
3. A title company.

These include:

- Requiring statutory retainage in the prime contract.
- Be aware of sham contract issues.
- Requiring payment and performance bonds from the general contractor.
- Getting lien waivers on the proper form from the general contractor and the subs and requiring them to be notarized and including the statement “subscribed and sworn to” in the notary portion.
- Being mindful of the claim notice, timing and retainage requirements so that claims can be properly evaluated for settlement.
- If termination of the General Contractor is unavoidable, sending a notice of termination to all the subcontractors that have sent any form of claim notice.
- Filing an affidavit of completion and sending a copy to all those from whom you have received a notice of claim.

A working knowledge of Chapter 53 of the Texas Property Code and the Amendments detailed below will help you manage the risks and avoid pitfalls that may arise from mechanics and materialmen’s liens. All references to the Property Code are to the Texas Property Code, Chapter 53, unless otherwise noted. References to “Section” refers to a section within Chapter 53 of the Property Code. Footnoted references to Amendment sections that take effect January 1, 2022, are generally referenced in the footnotes as “New Tex. Prop. Code Section 53.____.”

Statutory Retainage (or, the Hard Part First):

WARNING: This topic is fraught with issues and complications, so buckle up. Property Code Chapter 53, Subchapter E, requires an owner to retain ten percent of the total contract price until 30 days after completion. This has not changed materially in the Amendment. This pool of money out of which lien claims may be paid is referred to as the “retained funds” in the current statute but will be referred to as the “reserved funds” in the statute after the Amendments take effect. For now, I will use the current term “retainage,” which you can assume will mean “retained funds” after January 1, 2022.

Complying with the statute for retainage gives the owner certain protections. Most obviously, the retained funds give the owner a pool out of which to pay perfected lien claims. Subchapter E, Section 53.103 provides a safe harbor against certain lien claims *where the statutory retainage is held for 30 days from final completion*.⁴ I say there is protection against “certain claims” because there is a carve out for *retainage claims* under Section 53.103(2) that makes the 30 day safe harbor less than absolute. More on that below. That safe harbor created under Section 53.103 generally limits an owner’s liability to the total of trapped funds plus the required statutory retainage. Generally speaking, if the owner maintains statutory retainage and

⁴ Tex. Prop. Code Section 53.103:

A claimant has a lien on the retained funds if the claimant:

- (1) sends the notices required by this chapter in the time and manner required; and
- (2) except as allowed by Section 53.057(f), files an affidavit claiming a lien not later than the 30th day after the earliest of the date:
 - (A) the work is completed;
 - (B) the original contract is terminated; or
 - (C) the original contractor abandons performance under the original contract.

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