MUNSCH HARDT

COVID-19

Construction Owner Lien Notices Due to Economic Downturn

YOU ARE A CONSTRUCTION PROJECT OWNER RECEIVING LIEN NOTICES. WHAT DO YOU DO?

Unfortunately, it appears the country is heading towards a significant economic downturn, if we are not already there. For ongoing construction projects, this almost always leads to subcontractors ("subs") and sub-subcontractors ("sub-subs") not being paid and, consequently, sending lien notices or filing lien claims against the construction project. The Texas lien statute is notoriously complex and each lien claim generally must be handled on a case-by-case basis. But below are at least the minimal practical steps that should be considered by owners of these projects who start receiving lien claims.

For the discussion below, we are only talking about Texas projects where the owner is a private individual or company (e.g., hotels, condominiums / privately-owned apartment buildings, retail stores). For publicly-owned projects (e.g. construction of a new federal post office building, or a new stretch of highway by the Texas Department of Transportation), such projects generally cannot be subject to any lien claims and are not discussed below.

Speaking very generally, private project owners who want to reduce their lien exposure have essentially two obligations (unless a statutory bond, discussed below, is in place): 1) retain ten percent of the overall prime contract price for at least thirty days following completion of construction ("retainage"); and 2) generally withhold funds, after receiving the notices described below, until proper lien claims are paid. During construction, these private project owners might receive a letter from a sub or sub-sub, claiming they have not been paid and notifying you, the owner, that, if the claim is not resolved, your project property will be subject to a lien. Or somewhat worse, you might receive notice that the claimant has already filed an Affidavit Claiming Lien against the project in the real property records of the county where the project is located. What should you, the owner, do?

- **STEP 1: Check first: Is there a statutory payment bond furnished for the project?**

  This is the first step because, if the project has a "statutory" payment bond like the one we discuss immediately below, then the owner will generally be relieved of many of the headaches discussed below. It will still be wise for the owner to take many of the other steps discussed below, such as talking to the contractor ("GC") about the lien claim, demanding indemnity, having the GC send notice of "intent to dispute," and obtaining lien releases for paid claims. But you, the owner can feel better about the ultimate result of the project since, if a statutory bond is properly filed, ultimately no lien can be foreclosed on the owner's property.

  Many – maybe most – private projects do not have a statutory payment bond in place, but those that do typically have one that is furnished by the GC as principal on the bond. If there is a statutory payment bond, furnish a copy to the lien claimant. Also, the owner should be sure the statutory payment bond is filed of record in the property records of the county where the project is located, along with other steps required by the lien statute. If you, the owner, did require the GC to furnish a payment bond on the project, hopefully you had them furnish one that complies Subchapter I of the lien statute, what we refer to here as a statutory bond. If so, this is very good news; per the lien statute, if a valid statutory bond is filed, a lien claimant generally may not file suit against the owner or the owner's property and the owner is generally relieved of its obligations under the lien statute. The lien claimant here has a claim against the bond – which will now be the GC's headache, not the owner's – and the owner no longer has to worry about lien foreclosure against its property.

  Unfortunately for owners, not a lot of private projects have these statutory bonds in place. Some projects have a non-statutory "common law" bond in place; that can provide a good deal of relief as far as getting lien claimants paid, but it does not serve as the same guarantee provided by a statutory bond, namely, that no liens can occur. If there is no statutory bond in place, then you, the owner, need to be even more mindful of the other steps discussed below.

- **STEP 2: Call the GC ASAP – and MAYBE the lien claimant – and get their side of the story regarding why this claim by the sub or sub-sub / supplier has not been paid.**

  Sometimes the GC might tell the owner the reason this claimant has not been paid is, in fact, because their work was defective, or they have substantially delayed the project, or some other significant default under their contract by the lien claimant. Conversely, there might be a very innocent reason, such as there was an accounting error delaying payment and now that error has been fixed. Or conversely, and more ominously, the GC might not have a good reason, or maybe one of its subs has gone bankrupt. A key point is just for the owner to contact the GC as soon as possible, to try to start gathering as much information as possible.

  There might be an occasion – certainly not always – where the owner wants to call the lien claimant too, but if the owner does, it must do so cautiously. No matter how much the owner may want to evaluate any unpaid bill exposure that may be signified by lien claims, it can be important to resist direct contact with subs and sub-subs during the pendency of the notice periods specified by the lien statute; the owner might inadvertently assist an unpaid lien claimant with perfecting its lien claim against the property. Further, sometimes there are provisions in the GC-owner contract that forbid the owner from contacting the GC's subs / sub-subs directly. All the more reason for the owner to be cautious here.

  As you can see, and it is worth repeating: each claim must be handled on a case-by-case basis. Of course the GC's story is not the final word, but the conversation needs to happen and it needs to happen quickly. The steps that follow below might then depend on the answer to the question in this second step. For example, if there are significant problems with the lien claimant's work, the owner might not want to pay them; conversely, if there are no issues with the lien claimant's work, the owner might want to pay them in exchange for a lien release.

- **STEP 3: Depending on the answer to the question in Step 2, the owner may need to withhold money from the GC until the claim is handled.**

  First, know there is a reason why you, the owner, might be receiving these notices in the first place: the lien statute says the sub or sub-sub MUST send you prompt notice if they are owed money, including notifying you that your property may be subject to lien if they are not paid. If the sub / sub-sub does not send this notice, they may lose their right to a lien claim, under the lien statute's strictly enforced deadlines. Under that same statute, if the lien claim and notice letter is valid, the owner will want to strongly consider withholding further payment from the GC, in the amount of the claim, or otherwise ensuring the claim is paid or settled. If the owner instead ignores a valid claim and continues to pay the GC, the owner, and the owner's property may have increased liability under the lien statute.

- **STEP 4: If the lien claim is not going to be paid, tell the GC to send the owner written notice that the GC "intends to dispute the lien claim" and to do so within 30 days of the date of the claim letter.**

  This is more of an obscure issue, but there is a provision buried in the lien statute that says, within the 30 days of the GC's receipt of the lien claimant's demand for payment, the GC must give the owner written notice that GC intends to dispute the claim. Under the statute, if the GC fails to do this, the GC "is considered to have assented to the demand" and the owner may be required to pay the claim. Better to be safe than sorry. The owner should ensure the GC sends the owner this – relatively short – notice timely and be sure to keep a copy of this notice in the owner's project files. Out of an abundance of caution, the GC should send the notice via certified mail and email to the owner, as good proof the notice was sent.

- **STEP 5: The owner might send written demand to the GC for the GC to defend and indemnify the owner from such lien claim, particularly if the GC is dragging its feet / not providing satisfactory answers re: its handling of the lien claim.**

  Many owner-GC contracts have express provisions stating the GC must defend and indemnify the owner from any lien claims, including potentially requiring the GC to file a "bond to indemnify" against the lien. If your contract has such a provision, now might be a good time to send written notice to the GC that, per the contract, you are requiring them to defend and indemnify you from these lien claims or to get a bond to indemnify on file – translation: "Get this handled now." If the contract does require the GC to file a bond to indemnify, there are separate provisions in the lien statue that the owner will want to ensure the GC follows for this bond.

  The GC's failure to do any of the above, if required by the contract, might provide the owner an additional reason to withhold payment. Some additional background on this issue: another obscure provision buried in the lien statute requires a GC to essentially defend and indemnify an owner from any lawsuits based on lien claims. Finally, this is all good information to have, but of course the owner's right to indemnity / defense from the GC is only as good as the financial ability of the GC; that is, if the GC is itself heading towards bankruptcy, the owner might not have anyone there to defend and indemnify it. All the more reason to try to get out ahead of these issues early, as noted above.

- **STEP 6: If the lien claim is paid in full, be sure to obtain a lien release.**

  If the lien claim is paid in full, the owner will want to make sure the GC promptly obtains a lien release from the lien claimant. Frankly, the GC will have an interest in doing this as well, given its defense / indemnity obligations discussed immediately above. The owner will want the release to broadly cover any construction lien right, any right arising from a payment bond that complies with a state or federal statute, any common law payment bond right, any claim for payment, and any rights under any similar ordinance, rule, or statute related to claim or payment rights for persons in the position of the person that signs the release. Shortly after the release is obtained, particularly for large lien claims, the owner may want to have the release filed in the property records of the county where the project is located.

- **STEP 7: When the overall project is completed, the owner might file with the property records a statutory Affidavit of Completion and send a copy to any sub / sub-sub who has sent the owner any type of notice related to the project.**

  The lien statute provides for the owner, if it chooses, to file with the county clerk of the county in which the project is located an "Affidavit of Completion," stating, among other things, that the improvements under the GC's contract (i.e., the entire project) have been completed and stating the date of such completion. The value to the owner of this Affidavit of Completion is, if all statutory procedures are followed, it can significantly shrink the universe of potential lien claimants with which the owner may have to deal. Specifically, a lien claimant generally may not have a lien on the owner's retainage (10% of the overall contract price, noted above) unless the claimant files an affidavit claiming a lien within 40 days after the date the overall project was completed. The deadlines and other parts of the affidavit are too complex to discuss here, but speaking very generally, the same day the Affidavit of Completion is filed, the owner will want to send a copy (certified / registered mail) to the GC and any other lien claimant from which the owner received any type of notice regarding the project.

- **STEP 8: A note for owners of leased space.**

Private owners of leased space (tenants) – for example, an owner of a substantial office space, restaurant, or retail store – have a separate set of issues. In addition to the steps noted above, these tenants would be wise to take an early look at their lease agreement to see if there are provisions requiring the tenant to have any liens promptly released or bonded around. For most sophisticated leases, those provisions are there and the tenant needs to take quick action to address the lien, or otherwise potentially be in violation of its lease. Relatedly, for these tenants, communicating early and often with the landlord / land owner – letting them know that you are on top of the lien and are taking certain steps to have it released or bonded around quickly – can make a big difference in maintaining your lease rights as well as good landlord-tenant relations. It is also worth noting here, for informational purposes, that the lien claim – for a GC who contracted with a tenant – generally can only attach to the tenant's property, not the landlord's, and that once the lease ends then the GC's right to lien ends. Finally, while it is a separate, complicated issue that cannot be discussed at length here, if you, the tenant owner, cannot pay your GC (who then cannot pay its subs) as a result of COVID-19 related shutdowns, part of this discussion with your landlord may include invoking the force majeure clause in your lease agreement (if any); more in depth discussion regarding multiple COVID-19 issues facing tenants can be found under the "Construction" and "Real Estate" tabs on our **COVID-19 Business Response Team page here**.

In conclusion, if it was not already clear from the above, the lien Texas lien statute is very complex, so you, the owner, will generally want to consult a Texas construction lawyer once these issues start popping up. But hopefully the above will give you and your team a solid game plan to keep in mind if (and when) lien notices start coming across your desk.

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