

Recession Planning: Protecting Rights to Payment by Understanding the Texas Lien Statute



Jeff Chapman



Last month this column addressed reservation of rights with an eye towards the winds of recession that have been blowing recently. Again, while the signals of an impending economic slowdown are mixed, an ounce of prevention is worth a pound of cure. Protecting one's right to payment and understanding how to be proactive in projecting and protecting cashflow is the prevention to keep oneself out of costly payment disputes where there may only be an empty pot at the end of the rainbow.

In addition to ensuring rights to payment are not waived accidentally, contractors can institute best practices to ensure payment rights are protected and preserved in the event a recession happens and money starts getting tight. One best practice is to train project management or accounts receivable staff to implement proactive lien and bond protection and perfection practices. This article will focus on liens. Look for next month's column to address bond claims.

On private commercial projects, lien rights protect payment as opposed to public works where the real property enjoys a constitutional exemption to liens. Contractors working on private projects should train staff to understand the notice requirements and timelines required by the lien laws. For original or prime contractors, meaning those with a contract directly with the owner, no pre-notices are required. Notices are required for first and lower tier subcontractors and suppliers. Understanding notice and filing requirements is essential because many payment claims fail due to inadequate notice.

To perfect a statutory lien, an affidavit claiming a lien must be filed by the 15th day of the fourth month after indebtedness accrues. Indebtedness to an original contractor accrues on the last day of the month in which the contract was completed, terminated, or abandoned. Indebtedness to a subcontractor or supplier accrues on the last day of the last month in which labor or material was supplied to the project. Finally, indebtedness accrues

as to retainage accrues on the last day of the month when the work required by the original contract has been completed, or the original contract was terminated or abandoned.

In addition to filing an affidavit as required, subcontractors and suppliers are required to provide pre-lien notices to the owner and contractor in order to preserve rights to payment. A retainage notice is also required to perfect a retainage lien as those funds are treated differently by the lien statute than progress payments. To perfect a retainage lien, a subcontractor or supplier is required to provide notice to the original contractor and the owner that the claimant has entered into a contract that contains a contractual retainage provision. The notice must be sent before 30 days following the completion of the subcontract or the original contract, whichever is earlier. The notice may be sent early. Nothing prevents sending this notice at the beginning of the job to preserve lien rights on retainage.

One section of the Texas lien law requires 10 percent retainage on all projects for which lien may be claimed. As such, every private owner has a legal obligation to withhold 10 percent retainage from the general contractor for the benefit of potential lien claimants. While this same legal requirement does not flow downstream, any job for which retainage is not withheld by the owner makes the owner personally liable for unpaid retainage to claimants who follow the notice requirements in the statute. This liability is in addition to the right to foreclose a lien.

Another important point of statutory compliance to avoid accidental waiver of lien rights lies in the fact that notices required by the law have nothing to do with invoices or pay application submission. Timeliness for notices rests solely on the calculation from the date labor or materials are supplied to the project. Whether an invoice has been submitted covering that work does not matter as it related to lien perfection. Time for lien notices commences on the last day of a month in which materials and labor were provided. For example, if a

large volume of materials were delivered in the last week of a month but the pay application for those materials is not presented until the following month, the notice deadline is still based on the date of delivery.

In addition to the notices and affidavit that must be filed, the lien statute has other pitfalls for the unknowing. From a best practices standpoint for collections, enabling staff to attend a lien seminar or to secure a copy of a lien handbook through industry trade organizations – like the AGC – that provide these trainings is a good way to buy an ounce of prevention. The lien statute contains numerous challenging provisions. Its language is complicated and even trained professionals need to refer to the statute frequently. On the other hand, a project team trained on lien perfection as well as internal collection procedures can provide an extra layer of security for collecting debts where recession may be around the corner.

Understanding how to protect one's lien rights and how to prioritize your rights to payment over another unperfected claimant matter in business at all times. However, when a recession hits, this understanding plays a more important role in the health of any company. Contractors who get too far out over their skis and become overextended place themselves in financial peril. Those who make informed decisions and accept manageable risk fair better.

For ease of reference, the Texas lien statute is codified in Chapter 53 of the Texas Property Code and its language can be found through the Texas Legislature website. Be advised that the referenced website does take some time to update following a legislative session. No significant changes to the lien laws were made in the last session so the statute that can be found online is accurate as of the date of publication of this article.

“Protecting one's right to payment and understanding how to be proactive in projecting and protecting cashflow is the prevention to keep oneself out of costly payment disputes where there may only be an empty pot at the end of the rainbow.”