LEGISLATIVE UPDATE

Construction Law Section

Austin Bar Association

Presented: October 20, 2011

ROBERT C. BASS, JR.

WINSTEAD PC
401 Congress Avenue, Suite 2100
Austin, Texas 78701
(512) 370-2852
rbass@winstead.com

LEGISLATIVE UPDATE

A Regular Legislative Session in Texas is like watching an NBA game. Nothing really matters until the fourth quarter in most NBA games and very few legislative issues get resolved until the last month in the Session. In the case of this most recent Legislative Session (the 82nd Regular Legislative Session), it was more like an NBA game which ended regulation play in a tie and was forced into overtime.

To almost no one's surprise, most Legislators' time and attention was directed to the budgetary crises in Texas. Add redistricting for state legislative and Congressional districts, as well as other "hot-button" issues such as immigration/sanctuary cities, voter identification, "loser-pay", and sonograms before abortions, it is not surprising that many legislative issues were left unresolved by the end of the Regular Session. Statistically, 5796 House and Senate Bills were filed and only 1378 were finally passed and sent to the Governor for his approval or veto. That means less than 24% of all bills filed made it through the entire legislative process.

Of course, at the end of the day, almost 1400 enacted bills is still a lot of new legislation. Even though many of those bills deal with local and somewhat mundane issues, there were a number of significant bills passed by the Legislature and signed by the Governor – including several very significant bills impacting the construction industry.[1]

To their credit (and to the surprise of many observers), Legislators did manage to pass an Appropriations bill. However, it was incomplete because it omitted significant (and difficult) funding issues necessary for appropriations for the upcoming biennium.

Accordingly, immediately following the adjournment of the Legislature on Monday, May 30, 2011, the Governor issued his Proclamation calling the Legislature into Special Session the very next day. When the First Special Session finally came to a close on June 29, 2011, the Legislature had enacted the required ancillary funding measures, legislation relating to the continuation of the Texas Windstorm Insurance Association, healthcare cost containment, and congressional redistricting. No construction related legislation was enacted during the First Special Session.

Below is a brief discussion of the construction-related bills that passed both the House and the Senate during the 2011 Regular Legislative Session and received final action by the Governor. Following the discussion of enacted legislation, there is a discussion of several construction-related proposals or issues that were left "unfinished" (i.e., bills that died or issues that were defeated but which will almost certainly re-emerge in an additional Special Session, an "interim study", or the 2013 Regular Session ahead). See "Unfinished Business" below.

[1] The Governor vetoed 24 bills – none of which directly impacted the construction industry.

ENACTED LEGISLATION

Civil Justice / Dispute Resolution

HB 274 (Creighton, et al. / Huffman) -- *relating to the reform of certain remedies and procedures in civil actions and family law matters.*

This was the very controversial "loser pay" legislation that started out as a key piece of the Governor's tort reform agenda and included a provision allowing the prevailing party in any civil action, including a tort action, to recover its attorney's fees and costs of court. Primarily as a result of heavy lobbying by lawyers' groups on both sides of the tort reform debate, the legislation morphed into a relatively non-controversial bill that, among other things, directs the Texas Supreme Court to promulgate rules to permit a "motion to dismiss" procedure similar to that currently in use in Federal Court. It allows the court, on its own initiative (*i.e.*, without the agreement of the parties) to permit interlocutory appeals on controlling questions of law. And, it modifies the limitation on the formula for determining the maximum amount of attorney's fees recoverable as a result of a rejected offer of settlement.

One of the most significant impacts on construction litigation will probably be the provision that calls for the Supreme Court to adopt rules to promote expedited civil actions for claims involving less than $100,000 in dispute. A primary focus of the expedited procedures will be to address the increased costs of discovery in civil cases.

As everyone familiar with construction litigation understands, the costs of discovery and review of electronic communications has made litigation and arbitration cost-prohibitive for many disputes. While the dispute resolution costs may be reduced somewhat in the context of arbitration, the discovery costs remain extremely high. It will be interesting to see how the Supreme Court walks the fine line between making dispute resolution affordable without sacrificing parties' rights to full discovery.

HB 274 also amends Section 33.004 of the Civil Practice and Remedies Code relating to the designation of responsible third parties. Currently, subsection (e) of Section 33.004, revives claims otherwise barred by limitations against a person designated as a responsible third party (for a period of 60 days after the person is designated as a responsible third party). HB 274 repeals subsection (e).

Effective 09/01/2011 for civil actions commenced on or after the effective date.

HB 345 (Kleinschmidt/ Wentworth) -- *relating to limitations on awards in an adjudication brought against a local governmental entity for breach of contract.*

This bill amends the Local Government Code (Section 271.153) relating to the waiver of sovereign immunity in breach of contract actions against local governmental entities to permit the recovery of interest under the "Prompt Pay" statute (Chapter 2251, Texas Government Code).

Effective 09/01/2011.

Criminal History Background Checks

HB 398 (Jackson, Jim / Hegar) -- SB 1042 (Hegar / Jackson, Jim) -- *relating to the eligibility of employees convicted of certain offenses to provide services under a contract with a public school.*

As difficult as it is to manage to get one bill passed by both the House and Senate, occasionally two, identical bills manage to pass both the House and Senate, as ships passing in the night. Go figure. In this case, HB 398 and its companion bill in the Senate, SB 1042, were both finally passed and are identical.

In 2007, the 80th Legislature passed legislation which, among other things, required background checks for teachers, administrators, other school employees, and employees, and employees of businesses that contract with school districts. One unintended consequence of the 2007 legislation was that subcontractors were not required to check the background of their own employees, but general contractors were responsible for checking the background of both their own employees and the various subcontractors' employees. This created practical problems, and also legal problems, by requiring a third party to the employment relationship (the contractor) to be responsible for (and giving it access to) the employee criminal background information of another employer (a subcontractor or sub-subcontractor). In 2009, an amendment meant to correct the problem was added to the Department of Public Safety of Texas (DPS) Sunset bill (H.B. 2730). The Senate passed the DPS Sunset bill with this amendment. Due to a drafting error, the amendment created an unintended consequence by referencing the wrong section of the Education Code for the background check criteria. The section referenced was Section 21.060 (Eligibility of Persons Convicted of Certain Offenses), Education Code, which applies to teachers. The section that should have been referenced was Section 22.085 (Employees and Applicants Convicted of Certain Offenses), Education Code, which applies to non-teacher employees and contractor employees.

H.B. 398 and SB 1042 correct that drafting error by correcting the section number reference, thereby requiring employees of subcontractors and contractors to submit to the same background check as other similarly situated non-teacher employees, rather than the background check used for teachers.

Effective immediately (upon the Governor's signature or filing without signature).

Governmental Procurements

HB 628 (Callegari / Jackson) – *relating to contracts by governmental entities and related professional services and to public works performance and payment bonds.*

If there ever was a legislative effort that was truly "snake-bit", this would be it. For years, various groups, including the Texas Building Branch of AGC, the Texas Society of Architects, Texas Council on Engineering, and the Associated Builders & Contractors

have spent countless hours and considerable effort in attempting to take the various disparate statutes relating to state and local governmental procurements for construction projects and merge them into a single statute with uniform requirements. Past efforts have been vetoed twice (for reasons that probably have little or nothing to do with the substance of the proposed legislation) and have fallen victim to "chubbing" in the closing hours of the Session. Somehow (actually, with a lot of hard work by various industry groups), HB 628 managed to work its way through the House and the Senate this Session.

HB 628 creates a new Chapter 2267 of the Texas Government Code which will contain provisions for competitive bidding, competitive sealed proposals, procurement of professional services, construction manager at risk and construction manager agent delivery methods, design build method, and job order contracting which will apply uniformly to all state and local governmental entities (with very limited exceptions). For example, it takes the selected language regarding procurement and alternative delivery methods (Design-Build, Construction Management, Job Order Contracting, etc.) in Chapters 44 and Chapter 51 of the Education Code, Chapter 271 of the Local Government Code, and Chapter 2166 of the Government Code and consolidates that language into a new Chapter 2267 of the Government Code. The bill applies to public junior colleges, but not to institutions of higher education. The bill specifically exempts from the requirements of Chapter 2267: TxDOT; regional toll-road authorities; regional mobility authorities; and local government corporations currently exempt from competitive bidding requirements under Chapter 431 of the Texas Transportation Code. It prohibits reverse auctions in construction procurement.

HB 628 also provides for certain reforms in how school construction defect cases are handled. It requires notice of such suits to the Commissioner of Education and an opportunity for the Commissioner to join in the action, and it provides that recoveries on projects receiving State funding must be used for repair on the funded project. Any net recovery not used for repairs must be returned to the State. This could have an impact on "mass construction defect cases" brought by school districts as a funding source for future operational costs.

Effective 09/01/2011 for contracts or projects for which the governmental entity first advertises or otherwise requests or solicits bids, proposals, offers, or qualifications on or after the effective date.

HB 679 (Button / Carona) -- *relating to change order approval requirements for certain political subdivisions of the state.*

This bill modifies various provisions in the Texas Local Government Code to authorize officials or employees responsible for purchasing or administering a contract to approve a change order that involves an increase of decrease of $50,000 or less.

Effective immediately.

SB 1048 (Jackson / Davis) – r*elating to the creation of public and private facilities and infrastructure [Public/Private Partnerships]*.

In the current political climate with "tea party" enthusiasts railing against taxing and public spending and tight budgets for state and local governmental entities, the only viable way to finance many large public works projects is to forge some agreement with private investors to minimize or even eliminate the direct burden on taxpayers. Recent projects involving large sports venues, convention facilities (including convention hotels built on publicly owned property adjacent to or as part of the facilities), transportation facilities (including major airport improvements), parking garages on publicly owned property, government owned hospitals, and even court houses and governmental offices have involved some interaction between private developers (and the non-tax revenue funding sources and income streams they can help bring to the table) and the governmental entities that own the real property and intend to use the facilities (in whole or in part) for a public purpose. Generally, this development relationship has come to be known as a "Public Private Partnership" or a "P3".

While some governmental entities have developed very sophisticated P3 projects, current statutes governing the use of public property and funds, including statutes for competitive bidding and procurements, can be problematic for many governmental entities that would like to avail themselves of these opportunities.

Modeled after Virginia's Public Private Partnership ("P3") Law, SB 1048 establishes a process under which governmental entities may contract with private entities to construct, finance, and operate a variety of facilities, including ports, pipelines, parking garages, hospitals, schools, and other public works. State highways are not included. The bill provides for solicited or unsolicited proposals. Before considering a proposal the governmental entity must adopt guidelines including criteria for selection, financial review, timeline, and other issues. A proposal may be approved if it is in the public interest, subject to the execution of a comprehensive agreement. The entity may contract with the private party for services to be provided in exchange for service payments. The contracting person has the power to develop the project, collect payments, and assess user fees approved by the governmental entity. The comprehensive agreement must address plan review, inspection, insurance, termination, lease payments, business terms, and other issues. The contracting person is required to design and construct the project in conformance with design-build procedures in state law (Local Government Code, Education Code, etc.) and Chapter 2253 regarding bonding. The governmental entity and the contracting person must also comply with the Professional Services Procurement Act. A Partnership Advisory Commission is created within the legislative branch to review proposals for state government (as opposed to local government) projects.

SB 1048 does not establish mandatory and exclusive provisions for public/private ventures for development projects. A public entity may enter into P3's if they have any other statutory authority to do so. For example, it does not preclude "local government corporations" from entering into contracts for the development of property with private venture participants under Section 431.110 of the Texas Transportation Code. (The recent Love Field expansion project is a public/private venture with Southwest Airlines under the Texas Transportation Code provisions.) It does, however, provide a road map

for the public entity that is unfamiliar with the process and wants to consider such a partnership.

Effective 09/01/2011.

Licensing / Regulatory Requirements

HB 1711 (Davis / Jackson) – *relating to disaster remediation contracts.*

HB 1711 creates a new Chapter 57 to the Texas Business & Commerce Code, to regulate contracts for "the removal, cleaning, sanitizing, demolition, reconstruction, or other treatment of improvements to real property because of damage or destruction to that property caused by a natural disaster". This legislation, in part, grew out of issues that arose along the upper Texas Gulf Coast following Hurricane Rita in 2005. Contracts must be in writing, may not require any full or partial payment before commencement of the work, may not require payment in excess of an amount "reasonably proportionate to the work performed", and include a statutory disclosure. Failure to comply will be a "Deceptive Trade Practice" under Chapter 17, Texas Business & Commerce Code.

The statutory requirements do not apply to contracts with certain contractors licensed by TCEQ with regard to solid waste treatment or disposal or to contracts with contractors who have maintained a physical business address in the county (or an adjacent county) in which the property is located. In other words, local contractors do not have to comply with the new requirements.

Effective 09/01/2011 for contracts for disaster remediation services entered into on or after the effective date.

Indemnity / Insurance

HB 1951 (Taylor / Hegar) -- *relating to the continuation and operation of the Texas Department of Insurance and the operation of certain insurance programs; imposing administrative penalties.*

HB 1951 is the "Sunset" bill for the Texas Department of Insurance. For the most part, it deals with the operation of the Department and technical insurance issues. One provision, however, that directly impacts construction is the amended Section 3505.005 of the Texas Insurance Code relating to surety bonds required under Chapter 2253 of the Government Code (the former "McGregor Act") for public works projects and statutory payment bonds under Chapter 53 of the Property Code.

Currently (prior to the change in the law resulting from HB 1951), a surety writing statutory payment and performance bonds must be "Treasury-Listed" (on the list of the U. S. Department of Treasury as authorized for issuing bonds on federal projects) if the bonds exceed $100,000, or the surety must have obtained reinsurance for any liability in excess of $100,000. In other words, any liability over $100,000 is required to be covered (by the primary surety or reinsurance) by a Treasury-Listed surety or reinsurer.

HB 1951 changes the reinsurance threshold from $100,000 to $1 Million. However, what does that mean? If the amount of the bond exceeds $100,000, the surety does not have to be Treasury Listed as long as it has reinsurance for liabilities over $1 Million. Accordingly, if the bond amount is $950,000, it would appear that neither the surety nor the re-insurer must be Treasury Listed. HB 1951 also modifies the requirement for reinsurers. They no longer have to be "authorized" in Texas and be Treasury Listed. The reinsurer (for the liability in excess of $ 1 Million) must either be an "authorized reinsurer" in Texas or be Treasury Listed. Arguably, this puts public and private owners, as well as claimants, at additional risk for bonded projects under $1 Million.

Effective 09/01/2011, but only applies to insurance policies, contracts or evidences of coverage delivered or issued on or after January 1, 2012.

HB 2093 (Thompson / Van de Putte) -- r*elating to the operation and regulation of certain consolidated insurance programs.*

For almost the entire legislative Session, HB 2093 was simply a bill that sought to provide more transparency and uniformity to "consolidated insurance programs" (wrap policies) for construction projects. Notwithstanding much haggling among various groups, including carriers, large brokerage houses, general contractors, and public owner groups, compromise legislation finally emerged. Nothing earth-shaking. Its most important feature is to require all such policies to include completed operations coverage for no less than three years.

However, in the closing days of the legislative Session, HB 2093 became quite controversial as the "anti-indemnity" legislation (from SB 362 / HB 2010) was added to the bill.

Attempts to eliminate or restrict "broad form" and "intermediate form" indemnity have been the subject of industry in-fighting for almost as long as architects and engineers have been fighting over what their respective licenses allow them to do. Each Session, the subcontractor groups would file a bill to prohibit broad / intermediate form indemnity and defense obligations in construction contracts. Each Session, general contractors and owners would fight to kill that bill. Before long, Legislators grew weary of the fight. Several suggested that the industry associations work out a compromise or they would pass one that nobody liked. This resulted in a "mediated" compromise in 2009 between the Texas Building Branch-AGC, the Texas Construction Association, and the Texas Civil Justice League (also joined by the Associated Builders and Contractors of Texas) on a bill that would have banned "broad and intermediate" form indemnity and defense requirements, as well as Additional Insured coverage providing for broad or intermediate form indemnity, except in connection with employee bodily injury claims. That effort failed in 2009, primarily as a result of the late-hour "chubbing" in the House.

The 2009 opponents (mostly public and private Owners and some large, individual contractors) were more vocal in 2011. The Texas Civil Justice League dropped its support and became very actively opposed. As a result of the increased opposition to restrictions on the right of parties to contract freely for broad or intermediate indemnity and the over-

all legislative congestion resulting from the Legislature's pre-occupation with funding and appropriation issues, SB 362 / HB 2010 seemed doomed – until the language from those bills was added to HB 2093.

In order to remove some opposition, the "anti-indemnity" language was modified to exclude the statutory restrictions on broad and intermediate form indemnity in contracts for municipal public works and residential construction (*i.e.*, construction of single family homes, townhouses, duplexes, or land development directly relating thereto). As with the original "anti-indemnity" legislation, broad and intermediate form indemnities for employee injury claims and copyright infringement claims, as well as broad and intermediate form indemnity in loan documents and in general indemnity agreements obtained by sureties in connection with their underwriting process will continue to be allowed. Additionally, joint defense agreements entered into after a claim has been filed will be enforceable.

In a nutshell, HB 2093 does the following:

1. As a general rule, HB 2093 prohibits a person (the indemnitor) from indemnifying another person (the indemnitee) from claims or damages to the extent caused by the indemnitee's negligence. Indemnity clauses violating this prohibition will be void and unenforceable.

   This general prohibition applies to both claims arising from and to the extent of the indemnitee's sole negligence (which is "broad form" indemnity) and the indemnitee's partial negligence (which is "intermediate form" indemnity).

2. The general prohibition extends to obligations to defend claims (other than "joint defense agreements" entered into *after* a claim has been asserted). In other words, the contract cannot require an indemnitor to "defend" the indemnitee for claims based upon the indemnitee's negligence.

   The practical problem with this restriction on the defense obligation is that the decision to defend must be made before there is any finding of fault. Accordingly, this will mean that everyone will have to hire their own lawyers (which is already often the case in the real world.... especially for larger claims).

3. Additional Insured endorsements to an indemnitor's liability insurance policy that purport to provide coverage to an indemnitee for its sole or partial negligence are also void and unenforceable. This means that the currently available Additional Insured endorsements that provide coverage for the indemnitee's partial negligence, so long as the claim arises from the indemnitor's work, will no longer be enforceable in Texas. It is very likely that ISO will prepare specific Additional Insured endorsement forms for Texas (but see # 4 below).

4. The restrictions on indemnification (both with regard to claims and defense of claims) and on Additional Insured endorsements do NOT apply to on-the-job employee bodily injury claims. Accordingly, an indemnitee

can still make the indemnitor defend and indemnify the indemnitee for its sole, as well as partial, negligence for a personal injury claim by an employee of the indemnitor (or its subcontractors). This means that the current broad or intermediate form Additional Insured endorsements will still be enforceable in Texas for on-the-job personal injury claims.

5. While HB 2093 does restrict Additional Insured endorsements, parties can still obtain insurance to cover these risks. A "consolidated insurance program" (such as an OCIP or CCIP) can provide coverage for all named insureds (which really serves the same purpose as an Additional Insured endorsement to one party's insurance policy).

   Additionally, Owners can purchase an Owners and Contractors Protective Liability policy. This policy is often furnished by the Contractor through its CGL insurer, but it is a separate policy protecting the Owner from bodily injury and property damage claims arising out of ongoing operations performed for the Owner by the Contractor on a construction project and for the Owner's acts or omissions in connection with the "general supervision" of those operations. While it does not provide "completed operations coverage", it does cover the Owner's risk from "vicarious" or "derivative" liability claims arising from the ongoing work of the project. OCP policies are currently affordable and commercially available.

It should be noted that questions have been raised about the applicability of HB 2093 outside the context of Consolidated Insurance Programs because of the inclusion of the "anti-indemnity" language in Chapter 151 of the Insurance Code (as opposed to having that language set out in a separate Chapter of the Insurance Code or elsewhere in the statutes) and the definition of "contractor" in Sec. 151.001(3) (which applies to the entire Chapter, including the anti-indemnity language in Subchapter C). However, given the history of the prior anti-indemnity legislation and the circumstances of the last-minute amendment of HB 2093 to include that language, it is very clear that the proponents of the legislation did not intend that the restrictions on broad and intermediate form indemnity and additional insured endorsements would only apply in the context of a Consolidated Insurance Program.[2]

Over the course of the next few weeks, quite a lot will be written about HB 2093 and how it will impact the construction industry and the risk profile for Owners, General Contractors and Subcontractors. HB 2093 takes a surprisingly simple approach to the

[2] "Contractor" is defined in Sec. 151.001(3) as "any person who has entered into a construction contract and is enrolled in the Consolidated Insurance Program". This definition does apply to the use of that term throughout the entire Chapter 151. Accordingly, any use of the term "contractor" in the anti-indemnity portion of the legislation (Subchapter C) would appear to apply only to those contractors on projects where there is a Consolidated Insurance Program. The problem with that argument is that the anti-indemnity language in Subchapter C does not use the term "contractor". It does use the term "construction contract", but that definition in Sec. 151.001(5) is very broad (it applies to contracts entered into by owners, design professionals, construction managers, subcontractors, or contractors) and is not limited to contracts where a Consolidated Insurance Program has been implemented.

very complex issue of indemnity. It will remain to be seen if the approach works well. But, for better or worse, it will become the law (and will most likely remain the law until and unless changed in a future Legislative Session).

Effective 01/01/2012 for consolidated insurance programs for projects that begin on or after the effective date and for original contracts (and subcontracts thereunder) entered into on or after the effective date.

SB 425 (Carona / Hancock) – *relating to property and casualty certificates of insurance and approval of property and casualty certificate of insurance forms by the Texas Department of Insurance; providing penalties.*

A new Chapter 1811 entitled "Certificates of Property and Casualty Insurance" will be added to the Texas Insurance Code which will require forms for Certificates of Insurance for property and casualty coverage to be approved by the Texas Department of Insurance ("TDI"). Standard ACCORD forms will be deemed approved by TDI.

The statute clearly points out that a Certificate of Insurance is not a policy of insurance and does not alter, amend or extend coverage afforded by the referenced policy. It further provides that a property and casualty insurer or agent may not issue a Certificate of Insurance that purports to alter, amend, or extend the coverage or terms and conditions of the referenced insurance policy. It expressly provides that a Certificate of Insurance may not purport to give a person the right to notice of cancellation, nonrenewal, or material change with regard to the policy unless (a) that person is named in the policy or an endorsement to the policy and (b) the policy or endorsement requires such notice to be given to that person.

Third parties shall be prohibited from requiring insurers or agents to issue any document or correspondence that is inconsistent with statutory conditions and limitations with regard to Certificates of Insurance. Legislative intent (House floor debate) makes it clear that a party is not prohibited from requiring the insured to furnish copies of the actual policy of insurance and the endorsements.

Persons violating the statute are subject to a civil penalty of up to $1,000 for each violation.

The statute does not really answer the $64,000 question... "What is the real benefit of a Certificate of Insurance?" If someone really needs to confirm the existence of coverage with the carrier and/or the scope of insurance coverage, one really needs to see the respective policy and endorsements.

Effective 01/01/2012 for certificates of insurance issued on or after effective date.

Liens / Bonds

SB 539 (Carona / Kleinschmidt) – *relating to the award of costs and attorney's fees in certain proceedings concerning mechanic's, contractor's, or materialmen's liens.*

Section 53.156 of the Texas Property Code is amended by changing "may" to "shall" with regard to the Court's award of costs and reasonable attorney's fees in a proceeding to foreclose a lien, enforce a payment bond claim, or declare a lien or claim to be invalid or unenforceable. Late in the legislative process, language was also added to provide that the court is not required to order a property owner on a residential construction contract to pay costs and attorney's fees.

The intent of the legislation is to prevent Courts from not awarding attorney's fees to one side or the other in a suit to enforce a lien or bond claim. Technically, this does not convert the attorney's fee provision in the mechanic's lien statutes to a "prevailing party" provision (because the Court must still determine an award for costs and fees that are "equitable and just"). Accordingly, while the statute does appear to require the Court to make an award for "costs and reasonable attorney's fees", it does not necessarily mandate how much will be awarded (could we start having some $1 awards?) or to whom they will be awarded – except with regard to awards against property owners in an action relating to a residential construction contract.

The late added language regarding residential construction contracts is somewhat problematic. What does it mean when the statute requires the court to award attorney's fees in a proceeding but does not require an award against the owner? If the intent was to exclude residential projects from the mandatory language, why only have it apply to the property owner in those actions? Too much sausage making and not enough thought went into this one (of course, one can say that about most legislation).

Signed by Governor – effective 09/01/2011 for actions commenced on or after effective date.

HB 1390 (Deshotel / Estes) – *relating to retainage under certain construction contracts.*

Most practitioners would agree that the most complicated part of the Texas mechanic's lien laws has to do with the interplay between "statutory retainage" (which is somewhat unique to Texas law) and "contractual retainage" and the often misunderstood procedures for perfecting claims against those different types of retainage. For better or worse, HB 1390 makes significant changes in the statutory requirements for perfecting claims against both "statutory retainage" and "contractual retainage".

Currently, the deadline for a derivative claimant (a claimant other than an original contractor) to give a notice of contractual retainage is the 15th day of the second month following the first delivery of materials or performance of work after the claimant has agreed to the contractual retainage. Because of the early notice requirement, many subcontractors and suppliers fail to timely perfect lien claims for the contractual retainage withheld from their monthly progress payments. By the time many claimants realize that

there might be a problem with the payment of their contractual retainage, it is often too late to perfect a claim for most of that retainage.

Even if a notice is properly and timely sent under the current statute, claimants often lose their lien rights because they wait to file their lien affidavit within the extended time period permitted under Section 53.052 of the Texas Property Code (15th day of the 4th month after the claimant's indebtedness accrues). Because a notice of contractual retainage typically does not include "fund-trapping" language, the lien affidavit eventually filed by the claimant often perfects a claim limited to the "statutory retainage" the owner was required to withhold. If the owner has properly withheld statutory retainage for at least 30 days after final completion and has closed out the project before the claimant files its lien affidavit, the claimant may end up with a "timely" but worthless lien claim.

HB 1390 attempts to address both of these major problems for claimants. With regard to the notice of contractual retainage, HB 1390 extends the preliminary notice deadline by moving it to the 30th day after the claimant's work is completed, terminated or abandoned or the original contract is terminated or abandoned (whichever occurs first). Under current law, many claimants were required to send the notice before any significant work was done under their subcontract. Now, they can wait until their subcontract is complete (or the original contract has been terminated or abandoned) before sending the notice.

Because the preliminary notice will still not be a "fund-trapping" letter (arguably, a claimant could include "fund-trapping" language but most claimants will elect not to do so because of the problems it causes for owners and contractors in managing progress payments), claimants still have the problem of meeting the early deadline for filing a lien affidavit before the owner has paid out the statutory retainage (*i.e.*, 30 days after completion of the original contract).

HB 1390 addresses this problem by creating an exception to the early lien filing requirement for statutory retainage. If a claimant has properly and timely sent its notice of contractual retainage, the claimant does NOT have to file its lien affidavit to meet the early statutory retainage deadline. It can wait until the end of the extended period set out in Section 53.052. HOWEVER, that period can be cut short as follows:

1. If an owner files an affidavit of completion and the owner sent a copy of the affidavit to the claimant within the time and in the manner required under Sec. 53.106, the claimant must file its lien affidavit within 40 days after the date of completion stated in the affidavit;

2. If an owner sends a notice relating to termination or abandonment of the original contract to the claimant within the time and in the manner required under Sec. 53.107, the claimant must file its lien affidavit within 40 days after the date of termination or abandonment stated in the notice; or

3. If an owner sends a written notice of demand for the claimant to file its lien affidavit within the time and in the manner required under the newly added Sec. 53.057(g), the claimant must file its lien affidavit within 30 days after the owner sent the notice to the claimant.

To be sure, this all seems very complicated. However, HB 1390 addresses very complicated issues and is based upon an underlying logic that does make some sense. An owner can still have the benefit of an early close-out of the project by complying with the statutory retainage requirements. The close-out period does get extended by 10 days in most situations (as a practical matter it now becomes 40 days instead of 30 days after final completion). With regard to subcontractor retainage claims, the owner can be exposed to perfected lien claims for a significantly longer period of time (from the current "30 days after final completion" to the 15th day of the 4th month after the respective subcontractor's indebtedness accrues). However, HB 1390 gives the owner the ability to send a written demand to a claimant who has sent notice to require the claimant to file the lien affidavit early or lose its claim. This gives the owner a tool for getting all claims on record so they can be paid or "bonded around" within 40 days after the completion of the project. If the owner complies with the statute, it still gets almost the same protection for early close-out of the project as exists under current law.

HB 1390 also addresses a current ambiguity raised in *Page v. Structural Wood Components, Inc.*, 102 S.W.3d 720, 723 (Tex. 2003) where the Court arguably ignored *General Air Conditioning Co. v. Third Ward Church of Christ*, 426 S.W.2d 541 (Tex. 1968) by holding that a claimant who failed to file its lien affidavit within 30 days after completion lost its claim on statutory retainage even though it was not clear that the owner fully complied with the statutory retainage requirements. The *Page* Court based its holding on the fact that the claimant did not file its lien affidavit within the 30 day window. HB 1390 amends Section 53.105 to make it clear that a claimant does have a lien on statutory retainage if the owner does not comply with the statutory retainage requirements and the claimant complies with the lien perfection requirements in Subchapter C (*i.e.*, filing the affidavit within the extended lien filing deadlines).

Given the complexity of the issues and this legislation, it is recommended that all attorneys who represent owners, contractors, or potential lien claimants on construction projects spend some time reviewing the changes in HB 1390 before it goes into effect.

Good luck.

Effective 09/01/2011 for claims arising under original contracts (and subcontracts thereunder)entered into on or after effective date.

HB 1456 (Orr / Deuell) – *relating to the waiver and release of a mechanic's, contractor's, or materialman's lien or payment bond claim and to the creation of a mechanic's, contractor's, or materialman's lien for certain landscaping.*

A new Subchapter L entitled "Waiver and Release of Lien or Payment Bond Claim" is added to Chapter 53 of the Texas Property Code which provides for statutory forms for waiver and release of mechanic's liens and payment bond claims, both conditional (upon receipt of payment) and unconditional (full and final). In order for a waiver and release to be effective, the form of lien waiver and release must be in substantial compliance with the statutory forms.

Four statutory forms have been created: (a) Conditional Waiver and Release on Progress Payment; (b) Unconditional Waiver and Release on Progress Payment; (c) Conditional Waiver and Release on Final Payment; and (d) Unconditional Waiver and Release on Final Payment. Copies of these forms (set out *verbatim* from HB 1456) are attached hereto in the Appendix. The difference between "conditional" and "unconditional" is that a "conditional" waiver and release may be given prior to actual receipt of payment (i.e., it is conditioned upon a payment to be made).

You will note that the "conditional" waiver and release form specifically references the specific payment to be made. It cannot be used to require a claimant to provide a blanket waiver of its lien rights prior to a specific, promised payment. The statute expressly prohibits blanket contractual waivers of lien rights, except for contracts or subcontracts for labor or for labor and materials for construction or "land development" of residential (single-family, townhouse or duplex) projects. "Materials-only" contracts or subcontracts for residential projects cannot include blanket contractual waivers.

Although the forms include language in which the party signing the waiver and release "warrants" that it has already paid or will use the funds to pay in full all bills incurred for work covered by the payment, a lien waiver/release on the statutory form would not constitute a true "bills paid affidavit" under Section 53.085 of the Texas Property Code. Accordingly, there is some question whether true "bills paid" language (and a jurat) could be inserted in the statutory forms or whether separate affidavits must be used. Additionally, many waiver and release forms for progress payments currently being used by owners and contractors require an unconditional waiver and release for prior progress payments and a conditional waiver and release for the requested progress payment. Again, it is unclear whether that language can be combined into a single form or whether separate waivers/releases have to be furnished. Arguably, owners may end up requiring 3 separate forms to be provided by a contractor in connection with a progress payment (a bills paid affidavit, a conditional waiver for the requested payment, and an unconditional waiver covering the prior payments).

What if a claimant furnishes a waiver/release and still files a lien affidavit? For most claimants, they could be subject to the fraudulent lien statute (Section 12.002 of the Texas Civil Practices and Remedies Code). However, where there has been an enforceable contractual blanket waiver (see discussion above), the claimant will NOT be subject to the fraudulent lien statute unless the claimant fails to release its lien within 14 days after written notice from the owner or original contractor setting out the basis for nonpayment, evidence of the contractual waiver, and demand for release.

Interestingly, the statute expressly exempts releases furnished *after* a lien affidavit has been filed or a bond claim has been made. In other words, a party seeking a release of a perfected lien or bond claim will not have to use the statutory forms.

A last minute amendment was added in the Senate which was totally unrelated to waivers and releases. It amends Section 53.021(d) of the Texas Property Code with regard to the lien rights of persons providing landscaping services. Currently, in order to have a statutory lien, the claimant must have had a written contract with the owner or its agent. This effectively precludes many subcontractors from being able to perfect mechanic's liens for those services. HB 1456 amends that language so that the written contract can

be with a contractor or subcontractor. In other words, subcontractors furnishing landscaping services will be able to perfect statutory mechanic's liens.

Effective 01/01/2012 for contracts entered into / executed on or after effective date.

Professional Design Issues

HB 2284 (Hardcastle / Deuell) -- r*elating to the practice of architecture and engineering.*

For as long as anyone can remember, architects and engineers have argued over what constitutes the exclusive practice of "architecture" vs. "engineering". Most recently, much of the debate has surrounded the extent to which engineers may prepare complete, comprehensive sets of building plans for projects without involvement by licensed architects. In HB 2284, the architectural and engineering communities got together and came up with language that further defines those "common areas" of practice and those building design services that fall exclusively within the areas of architectural or engineering practice, respectively.

HB 2284 amends the licensing statutes for engineers (Chapter 1001, Texas Occupations Code) and architects (Chapter 1051, Texas Occupations Code) to define those professional services that can be performed by both engineers and architects. It also specifically provides that an engineer (who is not also a licensed architect) may not prepare or provide a complete, comprehensive set of building plans for a building designed for human use or occupancy (other than certain industrial projects and residential and commercial projects within prescribed statutory limits) unless the "architectural plans and specifications" (which is defined in a new Section 1051.0016 of the Occupations Code) has been prepared by or under the supervision of an architect or by an engineer who has received administrative approval by the Texas Board of Architectural Examiners to practice architecture under the new Section 1051.607 of the Occupations Code.

The newly added Section 1051.607 authorizes the Texas Board of Architectural Examiners to maintain a list of engineers who were licensed before January 1, 2011, and who can demonstrate that they prepared architectural plans and specifications for three or more projects that were adequately and safely built before January 1, 2011. Subject to certain statutory restrictions, those engineers approved by the Texas Board of Architectural Examiners will be authorized to lawfully engage in the practice of architecture based upon their engineering license, but they will continue to be regulated (even with regard to their practice of architecture) by the Texas Board of Professional Engineers. In other words, the architects and engineers agreed to "grandfather" experienced engineers who were licensed before January 1, 2011, but significantly tightened the restrictions for those not "grandfathered".

Effective 09/01/2011.

*** * * * * * ***

UNFINISHED / ONGOING BUSINESS
(VETOS / INTERIM STUDIES / SPECIAL SESSIONS)

Immigration

The various bills introduced during the Regular Session that would have required contractors to "E-Verify" all employees (and all subcontractor employees) did not pass. The Governor added "sanctuary cities" immigration legislation to his Call for the Special Session. Some thought that legislation would be amended to include "E-Verify" requirements; however, the sanctuary cities legislation did not pass.

Sovereign Immunity

Several bills were filed during the Regular Session relating to sovereign immunity, particularly with regard to contract claims against the State. Those bills were not successful; however, an amendment to the supplemental funding bill in the Special Session (**SB 1** by Duncan / Pitts) was added by Representative Paul Workman during House floor debate that incorporated language from his Regular Session HB 1041 (that had died in Committee during the Regular Session). The amended language would have provided for a waiver of sovereign immunity for contract claims against the State of Texas (the proposed waiver language was almost identical to the waiver provisions relating to claims against local and county governmental entities). However, this language was stripped from SB 1 before it was finally passed in the Special Session.

Construction Trust Funds

HB 1428 from the Regular Session (which did not pass) was the proposed change to the "Construction Trust Fund Statute" (Chapter 162, Texas Property Code) that would have required all retainage withheld by the owner from the contractor to be deposited and held in a trust account to the extent the funding came from loan proceeds. Under HB 1428, when the owner received a construction draw from the lender, the owner would have to deposit the "retainage" portion of the draw into a trust account. The contractor and other perfected lien claimants would have a priority (even over the lender) to those trust funds. The intent of HB 1428 was to address the situation where a lender takes over a project from a defaulted borrower/owner and forecloses on the project, wiping out the contractor's and the subcontractors' lien rights. Currently, the lender has no obligation to turn over the retainage to the contractor from the unfunded loan proceeds.

HB 1428 was not publicly opposed by lenders; however, it was opposed by owners and developers who complained that they would have to borrow the full amount of each loan draw and pay interest on the retainage.

This issue will almost certainly be raised by the contractor and subcontractor industry groups in 2013 or in any "Interim Study" on mechanic's liens.

Lien on Removables

HB 1860 from the Regular Session (which did not pass) proposed changes to Chapter 53, Texas Property Code, to attempt to better define those materials which constitute "removables" in connection with the priority lien on removables and to provide a mechanism for purchasers at foreclosure or title companies to require claimants to confirm their respective claim on removables. The purpose of the "confirmation" procedure was to cause the waiver of claims for removables unless a claimant timely responded to the notice by confirming its lien claim.

While one could argue that the proposed lien confirmation procedure in HB 1860 served no real useful purpose other than to put removables claims in jeopardy, the lending and title insurance industries do have legitimate concerns with the current ambiguities in the law relating to the lien on removables. Of course, from a claimant's perspective, that very ambiguity gives lien claimants more leverage in situations where they otherwise have precious little leverage. This is an issue that could be relatively easy to address from a drafting standpoint, but could be difficult to achieve from a political standpoint.

As with the issue of retainage and construction trust funds, removables will probably be the subject of proposed legislation in 2013 and any "Interim Study" on mechanic's liens.

Interim Studies

During the legislative "interim" (between "*sine die*" or final adjournment of the Regular Legislative Session on May 30, 2011, and when the 83rd Regular Legislative Session convenes on January 8, 2013) various Legislative Committees will conduct "interim studies" to take a more in-depth look at various legislative issues. While legislation is not enacted as part of an interim study, it is not uncommon for specific legislation to be drafted and proposed in the next Legislative Session as a result of an "interim study". Typically, legislation resulting from an interim study has a head start on other legislation filed in the upcoming Legislative Session.

Given the number of bills (both successful and unsuccessful) relating to mechanic's lien issues in 2011, it is very likely that one or more Legislative Committees will conduct an "interim study' on mechanic's liens. In such event, it is very likely that the respective Committee will look into retainage and removables issues. It is also possible that some thought will be given to a major revision of the lien laws, particularly with regard to creating a "pre-notice" system, along the lines of Florida and Arizona, where early notice (before work is performed and payment is past due) will serve as the first step in perfecting a direct lien on the full claim amount (*i.e.*, not limited to "fund trapping" or "statutory retainage") for subcontractors.

There is also a possibility that an interim study may look into issues relating to "inter-local" agreements and "job cost contracting" which local governments are using with increasing frequency for procurements. More specifically, concerns have been raised about the transparency with regard to the procedures for the selection of contractors for

"buying boards" (pools for job cost contractors) and the use of sole source specifications to reduce competition.

* * * * * * *

Special thanks to Mike Chatron and Corbin Van Arsdale with the Texas Building Branch – Associated General Contractors, Raymond Risk with the Texas Construction Association, John Fisher with the Associated Builders and Contractors of Texas, Scott Norman and Ned Munoz with the Texas Association of Builders, Peyton McKnight with the Texas Council of Engineering Companies, David Lancaster with the Texas Society of Architects, and especially Steve Nelson, minister without portfolio for multiple construction groups, for their assistance in locating and commenting on bills for this report. However, the opinions expressed herein are my own… you can't blame them for anything in this Paper.

APPENDIX:

STATUTORY LIEN WAIVER FORMS

1. **CONDITIONAL WAIVER FOR PROGRESS PAYMENTS**
2. **UNCONDITIONAL WAIVER FOR PROGRESS PAYMENTS**
3. **CONDITIONAL WAIVER FOR FINAL PAYMENT**
4. **UNCONDITIONAL WAIVER FOR FINAL PAYMENT**

[Note: the attached forms are duplicated *verbatim* (without editing) from HB 1456.]

FORM 1: CONDITIONAL WAIVER FOR PROGRESS PAYMENTS

* * * * * * *

CONDITIONAL WAIVER AND RELEASE ON PROGRESS PAYMENT

Project _____

Job No. _____

On receipt by the signer of this document of a check from _____ (maker of check) in the sum of $_____ payable to _____ (payee or payees of check) and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's 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 signer's position that the signer has on the property of _____ (owner) located at _____ (location) to the following extent: _____ (job description).

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to _____ (person with whom signer contracted) as indicated in the attached statement(s) or progress payment request(s), except for unpaid retention, pending modifications and changes, or other items furnished.

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project in regard to the attached statement(s) or progress payment request(s).

Date _____

_____ (Company name)

By _____ (Signature)

_____ (Title)

FORM 2: UNCONDITIONAL WAIVER FOR PROGRESS PAYMENTS

*** * * * * * ***

NOTICE: THIS DOCUMENT WAIVES RIGHTS UNCONDITIONALLY AND STATES THAT YOU HAVE BEEN PAID FOR GIVING UP THOSE RIGHTS. IT IS PROHIBITED FOR A PERSON TO REQUIRE YOU TO SIGN THIS DOCUMENT IF YOU HAVE NOT BEEN PAID THE PAYMENT AMOUNT SET FORTH BELOW. IF YOU HAVE NOT BEEN PAID, USE A CONDITIONAL RELEASE FORM.

UNCONDITIONAL WAIVER AND RELEASE ON PROGRESS PAYMENT

Project _____

Job No. _____

The signer of this document has been paid and has received a progress payment in the sum of $_____ for all labor, services, equipment, or materials furnished to the property or to _____ (person with whom signer contracted) on the property of _____ (owner) located at _____ (location) to the following extent: _____ (job description). The signer therefore waives and releases any mechanic's 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 signer's position that the

signer has on the above referenced project to the following extent:

This release covers a progress payment for all labor, services, equipment, or materials furnished to the property or to _____ (person with whom signer contracted) as indicated in the attached statement(s) or progress payment request(s), except for unpaid retention, pending modifications and changes, or other items furnished.

The signer warrants that the signer has already paid or will use the funds received from this progress payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project in regard to the attached statement(s) or progress payment request(s).

Date _____

_____ (Company name)

By _____ (Signature)

_____ (Title)

FORM 3: CONDITIONAL WAIVER FOR FINAL PAYMENT

* * * * * * *

CONDITIONAL WAIVER AND RELEASE ON FINAL PAYMENT

Project _____

Job No. _____

On receipt by the signer of this document of a check from _____ (maker of check) in the sum of $_____ payable to _____ (payee or payees of check) and when the check has been properly endorsed and has been paid by the bank on which it is drawn, this document becomes effective to release any mechanic's 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 signer's position that the signer has on the property of _____ (owner) located at _____ (location) to the following extent: _____ (job description).

This release covers the final payment to the signer for all labor, services, equipment, or materials furnished to the property or to _____ (person with whom signer contracted).

Before any recipient of this document relies on this document, the recipient should verify evidence of payment to the signer.

The signer warrants that the signer has already paid or will use the funds received

from this final payment to promptly pay in full all of the signer's laborers, subcontractors, materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project up to the date of this waiver and release.

Date _____

_____ (Company name)

By _____ (Signature)

_____ (Title)

FORM 4: UNCONDITIONAL WAIVER FOR FINAL PAYMENT

* * * * * * *

NOTICE: THIS DOCUMENT WAIVES RIGHTS UNCONDITIONALLY AND STATES THAT YOU HAVE BEEN PAID FOR GIVING UP THOSE RIGHTS. IT IS PROHIBITED FOR A PERSON TO REQUIRE YOU TO SIGN THIS DOCUMENT IF YOU HAVE NOT BEEN PAID THE PAYMENT AMOUNT SET FORTH BELOW. IF YOU HAVE NOT BEEN PAID, USE A CONDITIONAL RELEASE FORM.

UNCONDITIONAL WAIVER AND RELEASE ON FINAL PAYMENT

Project _____

Job No. _____

The signer of this document has been paid in full for all labor, services, equipment, or materials furnished to the property or to _____ (person with whom signer contracted) on the property of _____ (owner) located at _____ (location) to the following extent: _____ (job description). The signer therefore waives and releases any mechanic's 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 signer's position.

The signer warrants that the signer has already paid or will use the funds received from this final payment to promptly pay in full all of the signer's laborers, subcontractors,

materialmen, and suppliers for all work, materials, equipment, or services provided for or to the above referenced project up to the date of this waiver and release.

Date _____

_____ (Company name)

By _____ (Signature)

_____ (Title)