

Minimizing Liability of an Owner of a Texas Construction Project for Mechanic's Lien Claims

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While the Texas mechanic's lien laws codified in Chapter 53 of the Property Code can seem byzantine to the uninitiated, they represent a balance between the competing interests of a project owner and providers of labor and materials and present opportunities to an owner to minimize liability by complying with the statutory scheme.

From the standpoint of a provider of labor and materials, the provider just wants to get paid. If the party that provider contracted with and extended credit to doesn't pay, why not simply pass the buck up the chain to the project owner to make everything right? A project owner, on the other hand, is managing a construction project budget and wants to pay for everything only once and avoid making duplicate payments to a subcontractor because its general contractor didn't correctly pass on the funds. Why should an owner have to pay twice for the same labor and materials?

Chapter 53 of the Texas Property Code imposes two obligations on a project owner beyond the obligation to pay for labor and materials that it directly contracts for and correspondingly provides two avenues to the project owners to minimize their exposure to such liabilities.

The first obligation involves the concept of statutory retainage. Section 53.101 of the Texas Property Code imposes an obligation on the owner of a construction project to withhold 10% of the value of completed work out of payments to its direct contractors to create a "retainage fund" for the benefit of first and lower tier subcontractors down the line who don't receive a pass-through of the funds paid to the general contractor. This requirement is commonly misunderstood. It is not satisfied when the project is 90% complete and 90% of the contract price has been paid out. To comply with the retainage requirement, when the contract is 50% complete, the amount paid out should not exceed 90% of 50% (or 45%) of the total contract price and 5% of the total contract price should be held back as retainage. When the project is 90% complete, the amount paid out should not exceed 90% of 90% (or 81%) of the total contract price and 9% of the total contract price should be held back as retainage. Contractors do not like owners complying with statutory retainage requirements because it has the effect of deferring a large portion of their overhead and profit until the end of the job. However, compliance is the way for the owner to avoid liability beyond the contract price because the owner's liability to retainage claimants is limited to the amount retained under Section 53.103 or the amount which should have been retained under Section 53.105. The owner gets an additional benefit from the retainage in that if a large portion of the profit and overhead to the contractor is withheld until the end of the job, the contractor is much less likely to walk off of the job prior to completion. A

contract with a contractor who will allow the owner to comply with statutory retainage may be more advantageous to the owner than a contract for a lesser sum which does not permit statutory retainage.

After waiting 30 or more days after final completion of the general contract (note that this is final completion, not substantial completion), the owner may disburse the retainage funds to the general contractor in the absence of mechanic's lien claims lodged by subcontractors and properly perfected under Chapter 53.

If the statutory retainage is complied with, the owner can limit its liability for work performed under a general contract to the original contract sum, at least in theory. In practice, if there are mechanic's lien claims exceeding the amount of the retainage fund, the proper procedure for an owner is to interplead the retainage funds in an interpleader action naming all of the subcontractor claimants as parties. If this is done correctly, the owner has the ability to recover its attorneys' fees out of the interplead fund.

The second obligation Chapter 53 places on an owner requires that an owner receiving a notice from a subcontractor pursuant to Section 53.056 (commonly known as a "trapping notice") must withhold from payments subsequently due the contractor (in addition to the statutory retainage) the amount claimed in the "trapping notice" (although the statute is worded that the owner "may withhold," the owner is liable for not withholding so, for practical purposes, the "may" should be read as a "shall"). The subcontractor sending the trapping notice is required to send a copy of the notice to the general contractor under Section 53.083. In the absence of an objection properly lodged by the general contractor within 30 days after the general contractor receives such notice, the owner is entitled to pay the amount of the claim in the trapping notice directly to the subcontractor and receive a credit on its account with the general contractor in the corresponding amount. This has much the same effect as a garnishment action, but operating within the prejudgment time frame. If the general contractor does properly dispute the notice, the owner is once again in the interpleader situation with regard to the entitlement to the funds.

By scrupulously complying with statutory retainage and correctly responding to "trapping notices," an owner can limit its exposure to unbudgeted construction expenses.

The analysis above applies to privately owned real estate projects in Texas. Projects for state or federal governmental entities are outside the scope of this discussion. Other situations outside the scope of this discussion are situations involving contractual retainage arrangements between a contractor and a subcontractor beyond the statutory retainage provisions in the Texas Property Code.

