

Litigation and Arbitration of Mechanics' Lien Claims

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Litigation and Arbitration of Mechanics' Lien Claims

I.	Interplay Between Litigation and Arbitration.....	5
A.	Major Procedural Differences Between and Litigation and Arbitration	5
B.	Rules for Determining Whether an Agreement to Arbitrate Exists	6
C.	Whether a Court or an Arbitrator Decides Whether an Agreement to Arbitrate Exists	7
D.	Exceptions to Signing Requirement	7
II.	Common Litigation Issues	8
A.	Whether Arbitration Been Waived by Participation in Litigation	8
B.	Place of Suit	8
C.	Determining the Proper Court.....	9
III.	Common Arbitration Issues	9
A.	Choice of Arbitrator and Arbitration Rules	9
B.	Does the Federal or the Texas Arbitration Act Apply.....	9
C.	Fraudulent Inducement to Sign Arbitration Agreement	11
D.	Place of Arbitration	11
E.	Statute of Limitations Trap	11
F.	Who Are the Proper Parties to an Arbitration.....	12
G.	Appeal Procedures From Arbitrations	12
IV.	Substantive Legal Issues	12
A.	Prompt Payment Statute.....	12
B.	Recovery of Attorney's Fees.....	13
C.	Payments to Downstream Parties/Lenders/Trust Fund Statute.....	13
D.	Implied Contracts	14
E.	Notice of Claims.....	15
F.	Statutes of Limitations and Repose	15
G.	The Sham Contract Doctrine.....	16
V.	How to Enforce Mechanics' Liens.....	16
A.	Foreclosure of Liens	16
1.	Time Limits	17
2.	Arbitration/Litigation.....	17
B.	The Removables Doctrine.....	17

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By

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This article addresses issues that often arise in litigation or arbitration of mechanics' lien claims. A threshold issue, and the first that we discuss, concerns the effort to determine whether the claim should be decided in litigation or in arbitration. This involves determining whether an arbitration agreement exists and, if so, where arbitration must occur and which parties and claims are to be involved. Next, we will discuss issues specific to either litigation or arbitration, address substantive legal issues that are common to both, and then discuss how a successful lien claimant can enforce that lien.

I. Interplay Between Litigation and Arbitration

Litigation will be required to enforce every valid mechanics' lien even if the amount of the claim and the perfection of the lien is decided by an arbitrator. The Texas Property Code provides that only a court of competent jurisdiction can order foreclosure of a mechanic's lien and order the sale of the property. TEX. PROP. CODE §53.154. Suits to foreclose on mechanic's liens generally will involve proving that the all of the notice and filing requirements were met in order to obtain a judgment foreclosing the lien. However, if the contract between the owner and the original contractor contains an agreement to arbitrate, an arbitrator might first decide the technical issues such as whether the notices and lien affidavits were timely. *CVN Group v. Delgado*, 95 S.W.3d 234 (Tex. 2002). If the original contractor obtained a favorable arbitration award upholding the validity of the lien, suit would then be filed to enforce the arbitration award and foreclose on the lien.

Subcontractors and sub-subcontractors that do not have a contract with the owner should not be required to arbitrate their mechanic lien claims because they generally do not have contracts with the owner that require arbitration. However, clauses in subcontracts or sub-subcontracts that "incorporate" into them the terms of the contract between the original contractor and the owner or that list the owner/original contractor as a subcontract document might contain arbitration provisions. If the contract between the owner and original contractor called for arbitration, one might argue that by incorporating or referring to that contract a subcontractor or sub-subcontractor also agreed to arbitrate its mechanic's lien claims.

A. Major Procedural Differences Between and Litigation and Arbitration

Although litigation and arbitration are closely related, there are major procedural differences that can cause significant differences in result, expense, time of resolution and other considerations, such as:

- The rules that permit joinder of parties in arbitration are much more restrictive than those in litigation.
- The elaborate rules that allow appeals from virtually every aspect of a court trial are almost non-existent in challenges to arbitrations.
- Discovery is usually much more limited in arbitration than in court cases.
- The parties usually have some flexibility in choosing arbitrators but little choice of judges.
- The place where the arbitration occurs may be different from the place where the court case to foreclose the lien is located.

As a result of these and other differences, parties often spend much time and money arguing whether the merits of the dispute should be decided by a judge or an arbitrator before they ever get to the substance of the dispute.

B. Rules for Determining Whether an Agreement to Arbitrate Exists

The general rule is that a party must agree to arbitrate before it is bound to do so. Deciding this can be a difficult issue in a construction case. Construction contracts come in many forms, but almost all share a common feature: the document that will be presented for signature does not contain within its four corners all of the terms, conditions, specifications, and requirements that will apply to that contract. Instead, these terms will be supplied by a process known as “incorporation by reference” and the whole is typically described as the “Contract Documents.” This definition will typically be phrased very broadly and will include documents that may not be readily accessible to lower tier parties, and will almost always involve terms and conditions that have been negotiated or agreed to by other parties and which therefore cannot be modified. As a result, all of these documents must be reviewed and considered before making a decision about whether to proceed with litigation or arbitration.

For example, in *In re Premont Indep. School District 225* S.W.3d 329 (Tex. App. — San Antonio 2007, orig. proceeding) the Court of Appeals had to decide a “reverse” incorporation by reference case. In that case the school district sued its construction manager for delays and defective work. The manager asserted a contractual right to arbitrate but the trial court denied the motion. On appeal the school district argued that there was no arbitration agreement because although the A-121 contract incorporated section 4.5 of the A201 (containing the arbitration clause), the parties had adopted a supplementary condition striking that section. The construction management company argued that the supplementary conditions were not signed and therefore the arbitration clause was still valid. The Court of Appeals held that “an arbitration agreement that is not signed may be incorporated by reference in the signed contract Likewise, an agreement to not arbitrate that is not signed may be incorporated by reference in the signed document.” Because the contract documents did not require the supplementary

conditions to be signed the Court of Appeals held that no valid arbitration agreement existed.

C. Whether a Court or an Arbitrator Decides Whether an Agreement to Arbitrate Exists

Whether an agreement to arbitrate exists actually involves two inquiries. The Supreme Court's decision in *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995), discussed this point: "This determination [whether there is an agreement to arbitrate] depends on two considerations: (1) whether there is a valid agreement to arbitrate between the parties; and (2) whether the dispute in question falls within the scope of that arbitration agreement." The question of who decides these questions (arbitrator or judge) can be critical.

Parties are free to agree that an arbitrator may decide whether an agreement to arbitrate exists. But if there is no "clear and unmistakable evidence" of the parties' intention to have the arbitrator decide that issue, a reviewing court may decide the issues. *Kaplan, supra*. This means that a participant in an arbitration that has not agreed to submit the question of arbitrability to the arbitrator can later argue the point in court without waiving its right to independent court review, so long as it objects to jurisdiction during the arbitration proceeding. *Id.* at 946.

First Options of Chicago v. Kaplan also discussed that issue. It noted that if parties to a contract agree to allow the arbitrator to decide the issue of arbitrability the decision of the arbitrator is reviewable under traditional standards of review of arbitration decisions. On the other hand, if a party does not agree to arbitrability, it is entitled to an independent review of the issue by the courts. This flows "from the fact that arbitration is simply a matter of contract between the parties: it is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration." *Kaplan*, 514 U.S. at 943.

D. Exceptions to Signing Requirement

In *In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732 (Tex. 2005), the Texas Supreme Court considered whether a non-signatory to an arbitration agreement could be compelled to arbitrate. The Court in *Kellogg* recognized the following six exceptions to the general rule that non-signatories are not obligated to arbitrate because they have not agreed to arbitrate:

Federal courts have recognized six theories, arising out of common principles of contract and agency law, that may bind non-signatories to arbitration agreements: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) equitable estoppel; and (6) third-party beneficiary.

These rules can require a party that did not sign an arbitration agreement, such as a subcontractor, to arbitrate its disputes if it agreed to be bound to all provisions of a

contract that was incorporated by reference into its subcontract which contained an arbitration provision.

II. Common Litigation Issues

A. Whether Arbitration Been Waived by Participation in Litigation

A frequently disputed issue is whether an agreement to arbitrate has been waived by a party's participation in litigation. The Supreme Court last year said in *Perry Homes v. Cull*, 258 S.W.3d 580, 584 (Tex. 2008):

Since 1846, Texas law has provided that parties to a dispute may choose to arbitrate rather than litigate. But that choice cannot be abused; a party cannot substantially invoke the litigation process and then switch to arbitration on the eve of trial. There is a strong presumption against waiver of arbitration, but it is not irrebuttable and was plainly rebutted here. The Plaintiffs vigorously opposed (indeed spurned) arbitration in their pleadings and in open court; then they requested hundreds of items of merits-based information and conducted months of discovery under the rules of court; finally only four days before the trial setting they changed their minds and decided they would prefer to arbitrate after all. Having gotten what they wanted from the litigation process, they could not switch to arbitration at the last minute like this.

Thus, a party that intends to rely on an arbitration clause should raise the issue early if a suit is filed that might involve an arbitration clause.

B. Place of Suit

A provision in the Texas statutes (TEX. BUS. & COM. CODE §35.52) provides that if a contract is “principally for the construction or repair of improvements to rural property located in this state” and if it provides that the contract is subject 1) to the law of another state, 2) to litigation in another state, or 3) arbitration in another state, such a provision is voidable by the party obligated by the contract to perform the construction or the repair. This law will be re-codified in Chapter 272 of the Government Code April 1, 2009. Absent this statute, presumably the general rule that allows “forum selection” clauses to be enforced would govern. This could require a contractor to arbitrate its dispute related to a Texas project in an another state, and subject to that other state's rules. *In re: Lyon Finan. Servs*, 257 S.W.3d 228 (Tex. 2008). The *Lyon* case also recited the rule that fraudulent inducement to sign an agreement containing a dispute resolution agreement, such as an arbitration clause or a forum selection clause, will not bar enforcement of that clause unless it was the product of fraud or coercion, as opposed to a claim that the entire agreement, including the dispute clause, was the subject of fraud in the inducement or coercion.

C. Determining the Proper Court

One issue that is unique to court actions concerns the possibility of removal of a case to federal court if it is filed in state court, or to seek remand of a case to state court if it is filed in federal court. Federal courts are said to have “limited” jurisdiction, compared to states courts, which have “general” jurisdiction. The most common reason for jurisdiction in federal court is on the basis of “diversity jurisdiction,” which requires that there be complete diversity of citizenship among all parties to the case. That is, the plaintiff must be a resident of a different state than all of the defendants; if there are multiple defendants and one defendant has the same citizenship as the plaintiff, diversity jurisdiction does not exist. *See* 28 U.S.C. §1332. In the construction context, another basis of jurisdiction would be suit under the Miller Act (40 U.S.C. §§ 3131, et seq.) if a federal construction project were involved.

A similar situation exists in Texas state courts because a suit can be litigated in different counties. A defendant can seek a change of venue from the county where the suit is filed to a different county if certain factors are met. Venue can be significant because the judges or juries may vary from county to county.

III. Common Arbitration Issues

A. Choice of Arbitrator and Arbitration Rules

In arbitrations there are two very significant issues that arise even before any proceedings begin. The first is the choice of the arbitrator. The standard AIA contracts provide for arbitration by the American Arbitration Association (AAA). The AAA’s standard procedure calls for the submission of a list of potential arbitrators to all parties in the arbitration to seek information about potential disqualification. In some cases, parties may rank arbitrators who do not have a conflict. We have developed a chart to assist in this ranking process:

Rank	Name	Profession	Experience	ADR Experience	Compensation

A second issue that arises in arbitration cases before formal proceedings begin concerns the rules under which the arbitration is to be conducted. In some arbitrations the parties choose their own rules, and in others the parties use existing AAA rules. These rules can have an effect on the outcome and so they must be studied carefully before any commitments are made.

B. Does the Federal or the Texas Arbitration Act Apply

The question of whether the Texas General Arbitration Act (TGAA) or the Federal Arbitration Act (FAA) applies can have important consequences. One effect is how, and when, the trial court’s decision on whether to enforce the arbitration clause can

be challenged. If the TGAA applies the challenge must be by mandamus, but if the FAA applies the challenge may be taken by interlocutory appeal.

In *Northwest Constr. Co. v. Oak Partners, L.P.*, 248 S.W.3d 837, 844-845 (Tex. App. Fort Worth 2008, orig. proceeding), the court addressed whether the state or the federal act applied because this issue would govern whether it had jurisdiction to hear the case under the following rules:

In Texas, a trial court's denial of arbitration under the FAA may be challenged only by mandamus and not by interlocutory appeal. *In re D. Wilson Constr. Co.*, 196 S.W.3d 774, 779 (Tex. 2006) (orig. proceeding); *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 266, 272 (Tex. 1992) (orig. proceeding). But a party may seek to enforce an arbitration agreement under both the FAA and TGAA if, like the agreement here, it does not say whether the FAA or TGAA applies. *D. Wilson Constr. Co.*, 196 S.W.3d at 778-79. Texas appellate courts have jurisdiction over interlocutory appeals from the denial of arbitration under the TGAA only or under both the FAA and TGAA. TEX. CIV. PRAC. & REM. CODE ANN. §71.098(a)(1); *D. Wilson Constr. Co.*, 196 S.W.3d at 778-79.

The court ultimately decided that state law governed because the party seeking arbitration produced no evidence that the contract involved interstate commerce under the following test:

To determine whether an agreement that does not purport to be under either the FAA or TGAA is governed only by the FAA (i.e., whether the FAA pre-empts the TGAA), thus precluding an appellate court's jurisdiction over an interlocutory appeal, we must determine whether (1) the agreement is in writing, (2) it involves interstate commerce, (3) it can withstand scrutiny under traditional contract defenses, and (4) state law affects the enforceability of the agreement. 9 U.S.C.A. § 2; *D. Wilson Constr. Co.*, 196 S.W.3d at 780; *In re Nexion Health at Humble, Inc.*, 173 S.W.3d 67, 69 (Tex. 2005) (orig. proceeding). For the FAA to pre-empt the TGAA, state law must refuse to enforce an arbitration agreement that the FAA would enforce, either because (1) the TGAA has expressly exempted the agreement from coverage, or (2) the TGAA has imposed an enforceability requirement not found in the FAA. *D. Wilson Constr. Co.*, 196 S.W.3d at 780. In other words, the FAA pre-empts only contrary state law, not consonant state law. *Id.* at 779.

We conclude that the FAA does not pre-empt the TGAA here. Northwest has not directed us to, nor have we found, any evidence of interstate commerce in the record. Likewise, Northwest did not direct the trial court to any such evidence. Because this suit involves a construction project, it is possible that materials may have come from out of state, but Northwest has not directed us to anything in the record to support that conclusion, nor have we found any evidence in the record that would support such a

conclusion. See, e.g., *In re Nasr*, 50 S.W.3d 23, 25-26 (Tex. App.-- Beaumont 2001, orig. proceeding) (holding that construction contract involved interstate commerce because list of subcontractors in record included Wal-Mart). We hold that Northwest has failed to prove that the arbitration agreement involves interstate commerce; thus, the FAA does not pre-empt the TGAA in this instance, and we have jurisdiction over Northwest's interlocutory appeal. For the same reason, we do not have jurisdiction to grant relief on Northwest's petition for writ of mandamus. See *In re D. Wilson Constr. Co.*, 196 S.W.3d at 779. Because we have jurisdiction over the interlocutory appeal only, we will address Northwest's issues within the context of that proceeding.

C. Fraudulent Inducement to Sign Arbitration Agreement

According to the Texas Supreme Court, the test is:

[A]rbitrators generally must decide defenses that apply to the whole contract, while courts decide defenses relating solely to the arbitration clause. Thus, for example, arbitrators must decide if an entire contract was fraudulently induced, while courts must decide if an arbitration clause was. *Perry Homes v. Cull*, 258 S.W.3d 580, 589 (Tex. 2008).

D. Place of Arbitration

Many arbitration agreements state where the arbitration is to occur. The agreements are enforceable even if the place specified is inconvenient or if the state law to be applied limits the remedy that the complaining party wishes to obtain. See *In re Lyon Finan. Servs.*, 257 S.W.3d 228 (Tex. 2008).

E. Statute of Limitations Trap

As noted below, Texas law requires suits to foreclose mechanics' liens to be filed either one year (residential projects) or two years (commercial projects) after the lien must be perfected. If an arbitration is ongoing, these deadlines could run before a final decision of the arbitration case is rendered. To avoid the possible running the statute of limitations in this situation suit should be filed in the appropriate county before the statute runs, with a proposal that the court abate the case until the arbitration is decided.

In *Galbraith Engineering Consultants Inc. v. Pochucha*, the Texas Supreme Court recently agreed to decide whether a 10-year statute of repose barring a lawsuit against an engineer prohibits joining an engineer as a responsible third party under another statute that allows joinder despite expiration of a statute of limitations. The Pochuchas sued the contractor who built their house, then joined him as a defendant after the contractor designated him as a responsible third party. The trial court granted Galbraith summary judgment because he had not been sued within 10 years. The Court of Appeals reversed, holding that joinder was permitted even after limitations expired.

F. Who Are the Proper Parties to an Arbitration

Because of the rule that a party seeking to compel arbitration must show the existence of an arbitration agreement and show that the claims asserted fall within the scope of that agreement(see *Cappa Donna Elec. Mgt. v. Cameron County (In re Cappadona Elec.)*, 180 S.W.3d 364 (Tex. App. — Corpus Christi 2005, org. proceeding), a question frequently arises whether third-parties may be joined to an existing arbitration proceeding. If there are exceptions to this rule(incorporation by reference, assumption, agency, alter-ego, equitable estoppel, third-party beneficiary, and direct benefit estoppel cited above), the third-party cannot be joined.

An issue of particular interest concerns whether sureties on performance bonds may be joined. Several cases have allowed this to occur if the bond incorporates the terms of the bonded contract by reference, under the “incorporation by reference” theory. *J.S. & H. Construction Co. v. Richmond County Hospital Authority*, 473 F.2d 212 (5th Cir. 1973).

G. Appeal Procedures From Arbitrations

Last year in *Hall St. Assocs., LLC v. Mattel, Inc.*, 128 S.Ct. 1396 (2008) the Supreme Court decided that an attempt by contract to expand judicial review was not enforceable under the Federal Arbitration Act. Instead, the Court limited judicial review to those theories which are permitted by the Federal Arbitration Act, which are set in the statute as follows:

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration-- "(1) where the award was procured by corruption, fraud, or undue means; "(2) where there was evident partiality or corruption in the arbitrators, or either of them; "(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or "(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. 9 U.S.C. § 11

IV. Substantive Legal Issues

A. Prompt Payment Statute

The Texas Prompt Payment Statute is set out at TEX. PROP. CODE ANN. ch. 28. It requires an owner who has received a written payment request from a contractor to make payment of amounts for properly performed work or properly delivered materials to make payment not later than the 35th day after the date the owner receives the request. There is an exception for a good-faith dispute. The statute allows interest to accrue at the rate of

1-1/2 percent per month beginning on the date that payment is due, and allows the recovery of attorneys' fees in a case brought to enforce a claim under the statute.

B. Recovery of Attorney's Fees

The recovery of attorney fees in a contested case can become very important, because the amount of fees approaches and sometimes exceeds the amount of actual damages in question.

Under Texas substantive law attorney fees are recoverable under several claims, such as breach of contract, a suit to foreclose a mechanics' lien, declaratory judgment, the prompt payment statute, and for violation of the construction trust fund statute.

In actions concerning construction of federal projects the recovery of attorney fees is more limited. The U. S. Supreme Court has held that attorney fees will not be awarded in a Miller Act suit absent an enforceable contractual agreement or evidence that the opponent has acted "in bad faith, vexatiously, wantonly, or for oppressive reasons." *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 126 (1974).

In addition, although Texas courts have recognized that the Miller Act does not preclude supplemental jurisdiction of state law claims for attorney fees by and against contractors, such claims are not valid against the surety. *United States ex rel. Cal's A/C and Elec. v. Famous Const. Corp.*, 220 F.3d 326, 329 (5th Cir. 2000); *United States ex rel. Varco Pruden Buildings v. Reid & Gary Strickland Co.*, 161 F.3d 915, 918 (5th Cir. 1999); and *United States ex rel. Howell Crane Company v. U.S Fidelity & Guaranty Company*, 861 F.2d 110, 113 (5th Cir. 1988).

C. Payments to Downstream Parties/Lenders/Trust Fund Statute

Contractors frequently find themselves in the middle, receiving payment from one party and then providing payment to another. There are at least two obligations of a contractor to use funds in this fashion. The first will be found in contract documents, such as the contract itself, or in payment applications, which may direct the contractor to pay bills for the project from the funds that the contractor is receiving. The second source of this obligation in Texas is at Chapter 162 of the Property Code, which contains the trust fund statute. Under this law, all monies paid to a contractor or a subcontractor under a construction contract and all loans received by a contractor or subcontractor, or owner, for the improvement of real estate are "trust funds" for the benefit of the persons who furnish labor or materials. In residential cases a contractor is required to maintain separate accounts for each project. Although contract documents might require this, the statute does not require this in the case of commercial construction. A contractor can defend a claim that it has violated the trust fund statute if it shows that funds were used to pay its "actual expenses directly related to the construction or repair of the improvement." Case law adopts a fairly generous view of this. For example, overhead expenses can be paid with construction trust funds as long as they were actually incurred and necessary to obtain or complete the project. *Lively v. Carpet Servs., Inc.*, 904 S.W.2d 868, 876 (Tex. App.—Houston [14th Dist.] 1995, pet. denied).

Another situation in which a problem can be encountered occurs when a contractor grants a security interest in its accounts receivable to a lender. The trust fund statute does not apply, under its terms, to a lender, title company, closing agent, or payment bond surety. TEX. PROP. CODE ANN. §162.002. The Texas Supreme Court has held that a bank's perfected lien on a contractor's accounts receivable has priority over the claims of subcontractors and suppliers which fail to perfect their mechanic's liens. *Republic Bank Dallas, N.A. v. Interkal, Inc.*, 691 S.W.2d 605 (Tex. 1985). After the *Interkal* case was decided, the mechanic's lien statute (TEX. PROP. CODE ANN. § 53.151(a) was amended to provide that subcontractors, suppliers, and mechanics obtain a priority interest in funds over other general creditors. *In re Waterpoint Int'l LLC*, 330 F.3d 339 (5th Cir. 2003) held that Section 53.151 protected subcontractors, laborers and materialmen which had perfected their lien rights, but not otherwise.

D. Implied Contracts

If there is no formal contract between a claimant and an alleged responsible party (or sometime even if there is) the claimant may seek recovery under the theories of quantum meruit or unjust enrichment. These are equitable remedies based on an implied agreement to pay for benefits received.

A common situation arises when a contractor agrees to perform work for a set fee, but then encounters changed conditions and performs extra work without an agreement for the amount to be charged for the extra work. This was the case in *Brender v. Sanders Plumbing, Inc.*, 2006 Tex. App. Lexis 6354 (Tex. App.--Fort Worth 2006, pet. denied), which affirmed a judgment for a contractor. The court said:

The right to recover in quantum meruit is based upon a promise implied by law to pay for beneficial services rendered and knowingly accepted. *Black Lake Pipe Line Co. v. Union Constr. Co.*, 538 S.W.2d 80, 86, 19 Tex. Sup. Ct. J. 318 (Tex. 1976), overruled on other grounds by *Sterner v. Marathon Oil Co.*, 767 S.W.2d 686, 32 Tex. Sup. Ct. J. 266 (Tex. 1989); *Residential Dynamics, LLC v. Loveless*, 186 S.W.3d 192, 198-99 (Tex. App.--Fort Worth 2006, no pet.). To recover under quantum meruit, the plaintiff must prove that (1) valuable services and/or materials were furnished, (2) to the parties sought to be charged, (3) which were accepted by the parties sought to be charged, and (4) under circumstances that reasonably notified the recipient that the complaining party, in performing, expected to be paid by the recipient. *Heldenfels Bros., Inc. v. City of Corpus Christi*, 832 S.W.2d 39, 41, 35 Tex. Sup. Ct. J. 802 (Tex. 1992). If a valid express contract covering the subject matter exists, there can be no recovery upon a contract implied by law. *Woodard v. Southwest States, Inc.*, 384 S.W.2d 674, 675, 8 Tex. Sup. Ct. J. 145 (Tex. 1964). However, the existence of an express contract does not preclude recovery in quantum meruit for the reasonable value of services rendered and accepted that are not covered by the contract. *Black Lake Pipe Line Co.*, 538 S.W.2d at 86.

E. Notice of Claims

Many contracts contain very short time periods for a contractor to provide notice of claims and require the notice in particular forms and to particular parties. Although courts generally hold that a party which breaches its contract first cannot rely on such requirements, contractors are always better off by providing the notices required. The notice requirements cannot be satisfied without knowledge of what they require, so the contractor is advised to read these requirements carefully.

F. Statutes of Limitations and Repose

Statutes of limitations set time periods within which lawsuits must be brought after the right to bring them has “accrued” (begins to run). This occurs when a wrongful act causes an injury, regardless of when the plaintiff learns of the injury. The applicable statute of limitations depends on the nature of the claim that is asserted and who is asserting it. In Texas, generally claims for personal injuries or for property damages must be brought within two years after the claims accrue. Claims for breach of contract or to recover debt must be brought within four years after the claims accrue.

It appears to be generally accepted that parties can agree by contract when a cause of action accrues. For example, Article 13.7 of the AIA 201 General Conditions has separate accrual provisions for “acts or failures to act” before substantial completion, between substantial completion and final payment, and after final payment. It is also possible to agree to the time period that suit can be brought, although in Texas an agreement that establishes a limitations period that is shorter than two years is void. TEX. CIV. PRAC. & REM. CODE ANN. §16.070.

It is not safe to assume that a tort claim must be brought within two years after the date that a project is completed. A concept known as the “discovery rule,” which applies in tort cases, might apply to extend the accrual date of a statute of limitations. For example, an owner might be able to assert that it did not know and could not with the exercise of reasonable diligence have discovered a design defect until a failure occurred, and thereby attempt to extend the accrual date for limitations to the date of actual discovery. *See M.D. Thomson v. Espey Huston & Associates, Inc.*, 899 S.W.2d 415 (Tex. App.—Austin 1995, no writ).

The nature of construction is such that a possible defect could remain hidden for many years until an injury results, meaning that a cause of action might not accrue for years after construction has been completed. In an effort to protect contractors and design professionals from never-ending liability, the Texas legislature has enacted a “statute of repose.” This statute (TEX. CIV. PRAC. & REM. CODE § 16.008) provides that a cause of action for wrongful death, personal injury or property damage that arises out of a defective or unsafe condition of any real property must be commenced within ten years after substantial completion of the improvement or commencement of operation of any equipment attached to real property. If the claimant gives written notice of the claim

within the ten-year period, however, the filing period is extended for two years from the date of that notice.

The effect of a statute of repose is to cut off a right to bring a claim that otherwise could be filed. After the time period set by the statute of repose expires, no cause of action can be brought for injuries or property damage resulting from damages caused by the unsafe premises.

There is a difference in the statute that protects design professionals and contractors. The statute that protects contractors (Texas Remedies Code § 16.009) does not apply if “willful misconduct or fraudulent concealment in connection with the performance of the construction or repair” has occurred. This provision does not exist in the statute that protects design professionals. In *Dallas Market Center Development Co. v. Beran & Shelmire*, 824 S.W.2d 218 (Tex. App.—Dallas 1991, writ denied), the court held that an allegation that a design firm committed fraudulent concealment did not extend the ten-year period set by the statute of repose, based on this distinction and the language of the statutes. The design professional is cautioned to take this into account when being asked to indemnify contractors.

G. The Sham Contract Doctrine

The Texas Property Code has a section titled “Sham Contract” (TEX. PROP. CODE § 53.026) that allows a subcontractor to be treated for the purposes of mechanics’ lien perfection and enforceability as an original contractor under three situations:

- The owner contracted with the purported general contractor and the owner “can effectively control the general contractor through ownership of voting stock, interlocking directorships, or otherwise”;
- The alleged general contractor “can effectively control the owner through ownership of voting stock, interlocking directorships, or otherwise”;
- The owner’s contract with the general contractor was made with no good faith intention that the general contractor was to perform the contract.

This provision is most frequently litigated or arbitrated if the subcontractor failed to provide proper notices of its lien or failed to perfect its lien timely, or both, because the rules that allow a general contractor to create and enforce its liens against an owner’s property are much easier to follow than those concerning subcontractors.

V. How to Enforce Mechanics’ Liens

A. Foreclosure of Liens

Once a lien is properly perfected by sending timely notices to the right entities and filing a timely lien affidavit (if required), a lien claimant must sue to foreclose the lien and get an order to sell the property to collect the debt. Suit to foreclose on a

mechanic's lien must be filed "in the county in which the property is located...." TEX. PROP. CODE ANN. § 53.157.

1. Time Limits

The deadline for filing suit to foreclose a lien on a commercial property is within two years after the last day a claimant may file a lien affidavit or within one year after completion, termination or abandonment of the work under the original contract, whichever is later. TEX. PROP. CODE §53.158(a). The deadline for residential properties is shorter. Suit must be filed within one year after the last day a claimant may file a lien affidavit or within one year after completion, termination or abandonment of the work under the original contract, whichever is later. TEX. PROP. CODE §53.158(b).

2. Arbitration/Litigation

The Texas Property Code provides that only a court of competent jurisdiction can foreclose on a mechanic's lien and order the sale of the property. TEX. PROP. CODE §53.154. Suits to foreclose on mechanic's liens generally will involve proving that the all of the notice and filing requirements were met in order to obtain a judgment foreclosing the lien. However, if the contract between the owner and the original contractor contains an agreement to arbitrate, in an action by the original contractor to enforce its mechanic's lien an arbitrator might first decide the technical issues such as whether the notices and lien affidavits were timely. *CVN Group v. Delgado*, 95 S.W.3d 234 (Tex. 2002). If the original contractor gets a favorable arbitration award upholding the validity of the lien, suit would then be filed to enforce the arbitration award and foreclose on the lien. Subcontractors and sub-subcontractors that do not have a contract with the owner should not be required to arbitrate their mechanic lien claims. However, beware of clauses in subcontracts or sub-subcontracts that "incorporate" into them the terms of the contract between to original contractor and the owner or that list the owner/original contractor as a subcontract document. If the contract between the owner and original contractor called for arbitration, one might argue that by incorporating or referring to that contract a subcontractor or sub-subcontractor also agreed to arbitrate its mechanic's lien claims.

B. The Removables Doctrine

The Removables Doctrine is involved if there is a contractual lien, such as a deed of trust and a mechanics lien on the same property. The general rule is that a mechanic's lien has priority based on the visible construction or supplied materials on the site. TEX. PRAC. & REM. CODE § 53.1424. If a deed of trust is recorded after that date, a properly perfected mechanic's lien should have priority over that lien. The question of whether the work was sufficient can give rise to an issue to be decided by a court or an arbitrator.

Even if the deed of trust existed before visible work began, the claimant has priority for materials supplied that can be removed without causing material damage to the land, pre-existing materials, or the materials themselves. Items that courts have held to be removable without material injury include dishwashers and disposals, carpets, appliances, air conditioning and heating components, smoke detectors, burglar alarms, light fixtures, door locks, fixtures, windows and doors, electrical wiring and conduit, and some floor coverings. Items that are almost certainly not removable would constitute

roofing materials, framing materials, the concrete slab, roofing tiles, brick, and other outside items used to shield or protect a structure from damage by the elements.