

BILL ANALYSIS

C.S.H.B. 3316
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Business & Industry
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Certain Property Code provisions grant a lien right, sometimes called a mechanic's and materialman's lien, to people who furnish labor or material to improve real property. Under those provisions, an owner is required to hold a specified percentage of the amount paid for such labor or materials during the project's progress until after the entire project is completed. This unpaid portion of the bill is known as retainage. Issues concerning retainage can arise when an owner defaults on obligations to the lender of construction funds. Interested parties observe that a number of cases have arisen in which, on an owner's default, the retainage is nowhere to be found, the owner is insolvent, or the owner claims the bank is holding the retainage when, in actuality, it is not. Those parties express concern that under such circumstances, the contractor, subcontractors, or other individuals who have provided services or supplies to the project only receive the portion of the payment that has not been retained and do not get paid the full balance due.

C.S.H.B. 3316 seeks to ensure that individuals who contribute to improvements of real property that are financed by a construction loan or financing agreement will be paid in full on completion of the project by requiring the property owner to put aside retainage in a trust fund account or purchase a bond for the retainage obligation for the benefit of those individuals.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

C.S.H.B. 3316 amends the Property Code to require a property owner who enters into a construction loan or financing agreement in order to pay toward the improvement of real property that is secured wholly or partly by a lien on the property or improvement to deposit in a construction trust fund account not later than contemporaneously with payment to a contractor any money withheld from the payment as retainage. The bill establishes that the deposited funds are held in trust for the benefit of an artisan, laborer, mechanic, contractor, subcontractor, or materialman who labors or who furnishes labor or material for the construction or repair of the improvement. The bill specifies that funds required to be deposited into a construction trust fund account under the bill's provisions are trust funds.

C.S.H.B. 3316 requires trust funds deposited in a construction trust fund account to be used first to satisfy the owner's obligations and liabilities for retainage and a claimant's rights under statutory provision relating to a mechanic's, contractor's, or materialman's lien. The bill authorizes trust funds remaining in the construction trust fund account after the satisfaction of those obligations, liabilities, and rights to be used by the owner for other construction payments or direct costs of the owner. The bill establishes that trust funds deposited into a construction trust fund account are not subject to seizure, offset, or taking by the financial institution or a creditor of the owner. The bill establishes that such provisions do not alter the owner's obligation

or liability under any other law.

C.S.H.B. 3316 exempts from the bill's requirement to deposit retainage in a construction trust fund account a property owner who enters into a construction loan or financing agreement to pay toward the construction, remodeling, or repair of a single-family house or duplex used for residential purposes, or for related land development. The bill also exempts a property owner improving real property if the value of the improvement to be made is \$500,000 or less.

C.S.H.B. 3316 authorizes a property owner, instead of establishing a construction trust fund account, to obtain a bond furnished by the contractor that meets certain requirements of a bond to pay liens or claims of a mechanic, contractor, or materialman, or to furnish a bond in a minimum penal sum that meets certain additional requirements prescribed by the bill and is conditioned on prompt payment for retainage owed to specified persons and for the protection and use of each claimant due prompt payment. The bill sets out requirements relating to the execution of such a bond and prohibits the bond from being subject to any notice or perfection obligation other than as may be required under a mechanic's, contractor's, or materialman's lien. The bill prohibits a suit from being filed on such a bond after the first anniversary of the later of the date of completion of the contract between the owner and contractor or the date on which retainage is due to the contractor.

C.S.H.B. 3316 sets out requirements relating to the contents of a periodic statement received from a financial institution with respect to a construction trust fund account based on whether the property owner maintains a separate construction trust fund account for each project or maintains a construction trust fund account into which funds for two or more projects are deposited. The bill requires a property owner that opens and maintains a construction trust fund account into which funds for two or more projects are deposited to maintain an account record for the account that provides certain information. The bill requires the owner, for each construction trust fund account maintained by the owner, to maintain the account record for each construction project for which trust funds have been deposited.

C.S.H.B. 3316 requires a property owner, not later than the 14th day after the property owner receives a written request from a person who is a beneficiary of trust funds, if the owner is maintaining a construction trust fund account, to provide the beneficiary with a copy of the periodic statement received from the financial institution regarding the appropriate construction trust fund account or an original executed authorization sufficient to allow the requesting person to obtain the periodic statement and to provide the beneficiary with the account record required to be maintained by the owner with respect to the construction project for which the trust funds have been deposited or, if a bond has been obtained or furnished in lieu of a trust fund account, requires a property owner to provide the beneficiary with proof of a bond.

C.S.H.B. 3316 authorizes a beneficiary, if a property owner does not provide such notice in the time required or if the information provided does not demonstrate that the owner has complied with the requirement to deposit funds in a construction trust fund account or to obtain a bond in lieu of a trust fund account, to suspend contractually required performance the 10th day after the date the beneficiary gives the owner written notice that states the intent of the beneficiary to suspend performance and the reason for suspending performance if the owner does not cure the grounds for suspension before the beneficiary suspends performance. The bill authorizes an owner to cure any grounds for such suspension of performance by complying with the requirements for a construction trust fund account or bond in lieu of such an account and providing proof of such compliance to the beneficiary. The bill establishes that a beneficiary that has suspended performance is not required to supply further labor, services, or materials before the date the owner cures the grounds for suspension and pays the beneficiary's costs for suspending performance and for resuming performance. The bill also establishes that such a beneficiary is not responsible for damages resulting from suspending performance unless the beneficiary continues to suspend performance after the 10th day after the owner has cured the grounds for suspension and paid the beneficiary for the costs.

C.S.H.B. 3316 specifies that an artisan, laborer, mechanic, contractor, subcontractor, or materialman who labors or who furnishes labor or material for the construction or repair of an improvement on specific real property in Texas is a beneficiary of any trust funds withheld as retainage or required to be deposited in a construction trust fund account in connection with the improvement.

C.S.H.B. 3316 makes it an affirmative defense to prosecution or other action brought for misapplication of trust funds required to be deposited into a construction trust fund account that the trust funds have been retained by the trustee, after notice to the beneficiary who has made a request for payment, as a result of the trustee's reasonable belief that the beneficiary is not entitled to such funds or have been retained as authorized under statutory provisions relating to a mechanic's, contractor's, or materialman's lien.

EFFECTIVE DATE

September 1, 2013.

COMPARISON OF ORIGINAL AND SUBSTITUTE

While C.S.H.B. 3316 may differ from the original in minor or nonsubstantive ways, the following comparison is organized and highlighted in a manner that indicates the substantial differences between the introduced and committee substitute versions of the bill.

INTRODUCED	HOUSE COMMITTEE SUBSTITUTE
SECTION 1. Section 162.001, Property Code, is amended.	SECTION 1. Substantially the same as introduced version.
SECTION 2. Section 162.003(a), Property Code, is amended.	SECTION 2. Same as introduced version.
No equivalent provision.	SECTION 3. Section 162.004(a), Property Code, is amended to read as follows: (a) This chapter does not apply to: (1) a bank, savings and loan, or other lender; (2) a title company or other closing agent; or (3) a corporate surety who issues a payment bond covering the contract for the construction or repair of the improvement, <u>except as provided by Section 162.0064.</u>
SECTION 3. Section 162.005, Property Code, is amended.	SECTION 4. Same as introduced version.
SECTION 4. Chapter 162, Property Code, is amended by adding Sections 162.0061-162.0064 to read as follows:	SECTION 5. Subchapter A, Chapter 162, Property Code, is amended by adding Sections 162.0061, 162.0062, 162.0063, 162.0064, 162.008, and 162.009 to read as

Sec. 162.0061. CONSTRUCTION TRUST FUND ACCOUNT REQUIRED IN CERTAIN CIRCUMSTANCES. (a)

Except as provided by this section, a property owner who enters into a construction loan or financing agreement to pay toward the improvement of real property that is secured wholly or partly by a lien on the property or improvement shall deposit in a construction trust fund account not later than contemporaneously with payment to a contractor any money withheld from the payment as retainage and the deposited funds shall be held in trust for the benefit of a person described by Section 162.003(a). Trust funds deposited in a construction trust fund account under this section shall be used first to satisfy the owner's obligations and liabilities for retainage and a claimant's rights under Chapter 53, Property Code. Trust funds remaining in the construction trust fund account after the satisfaction of those obligations, liabilities, and rights may be used by the owner for other construction payments under this chapter or direct costs of the owner. Trust funds under this section are not subject to seizure, offset, or taking by the financial institution or a creditor of the owner. This subsection does not alter the owner's obligation or liability under any other law.

(b) This section does not apply to a property owner who enters into a construction loan or financing agreement to pay toward the construction, remodeling, or repair of a single-family house or duplex used for residential purposes, or for land development related thereto.

(c) This section does not apply to a property owner improving real property if the value of the improvement to be made is \$500,000 or less.

Sec. 162.0062. BOND IN LIEU OF TRUST FUND ACCOUNT. (a) In lieu of complying with Section 162.0061(a), a property owner may obtain a bond described in Subsections (b), (c) or (d).

(b) A bond furnished by the contractor that meets the requirements of Section 162.0063 and the following requirements:

follows:

Sec. 162.0061. CONSTRUCTION TRUST FUND ACCOUNT REQUIRED IN CERTAIN CIRCUMSTANCES. (a)

Except as provided by this section or Section 162.0062, a property owner who enters into a construction loan or financing agreement to pay toward the improvement of real property that is secured wholly or partly by a lien on the property or improvement shall deposit in a construction trust fund account not later than contemporaneously with payment to a contractor any money withheld from the payment as retainage. The deposited funds are held in trust for the benefit of a person described by Section 162.003(a). Trust funds deposited in a construction trust fund account under this section shall be used first to satisfy the owner's obligations and liabilities for retainage and a claimant's rights under Chapter 53. Trust funds remaining in the construction trust fund account after the satisfaction of those obligations, liabilities, and rights may be used by the owner for other construction payments under this chapter or direct costs of the owner. Trust funds under this section are not subject to seizure, offset, or taking by the financial institution or a creditor of the owner. This subsection does not alter the owner's obligation or liability under any other law.

(b) This section does not apply to a property owner who enters into a construction loan or financing agreement to pay toward the construction, remodeling, or repair of a single-family house or duplex used for residential purposes or for related land development.

(c) This section does not apply to a property owner improving real property if the value of the improvement to be made is \$500,000 or less.

Sec. 162.0062. BOND IN LIEU OF TRUST FUND ACCOUNT. (a) Instead of establishing a construction trust fund account under Section 162.0061(a), a property owner may obtain or furnish a bond as described by Subsection (b) or (c).

(b) A property owner may obtain a bond furnished by the contractor that meets the requirements of Subchapter I, Chapter 53.

- (1) be in a penal sum at least equal to the total of the original contract amount between the owner and the contractor;
- (2) be conditioned on prompt payment for all labor, subcontracts, materials, specially fabricated materials, and normal and usual extras not exceeding 15 percent of the contract price; and
- (3) be for the protection and use of all persons that are due prompt payment under Subsection 162.0062(b)(2).

(c) A bond furnished by the owner that meets the requirements of Section 162.0063 and the following requirements:

- (1) be in a penal sum at least equal to 10 percent of the value of the total of the original contract amount between the owner and the contractor including 10 percent of normal and usual extras not exceeding 15 percent of the original contract amount;

(2) be conditioned on prompt payment for retainage owed to a contractor by an owner; and

- (3) be for the protection and use of all persons that are due prompt payment under Subsection 162.0062(c)(2).

(d) a bond furnished by the contractor that meets the requirements of Section 162.0063 and the following requirements:

- (1) be in a penal sum at least equal to 10 percent of the value of the total of the contract amount between the owner and the contractor including 10 percent of normal and usual extras not exceeding 15 percent of the original contract amount;

(2) be conditioned on prompt payment for contractual retainage owed for all labor, subcontracts, materials, specially fabricated materials, furnished by any person to a contractor or to accomplish work owed by a contractor under a contract between a contractor and an owner; and

- (3) be for the protection and use of all persons that are due prompt payment under Subsection 162.0062(d)(2).

Sec. 162.0063. REQUIREMENTS FOR BOND. A bond under Section 162.0062 must meet the following requirements:

(c) A property owner may furnish a bond that:

- (1) meets the requirements of Section 162.0063;

(2) is in a penal sum at least equal to 10 percent of:

(A) the value of the total of the original contract amount; and

(B) normal and usual extras not exceeding 15 percent of the original contract amount;

(3) is conditioned on prompt payment for retainage owed for all labor, subcontracts, materials, and specially fabricated materials furnished by any person to accomplish work required under a contract between a contractor and an owner; and

- (4) is for the protection and use of each claimant who is due prompt payment under Subdivision (3).

No equivalent provision.

Sec. 162.0063. ADDITIONAL BOND REQUIREMENTS. A bond furnished under Section 162.0062:

- (a) be executed by:
- (1) the contractor as principal if furnished under Section 162.0062(b) or (d) or by the owner as principal if furnished under Section 162.0062(c); and
 - (2) a corporate surety authorized and admitted to do business in this state and licensed by this state to execute bonds as surety subject to Sections 3503.001-3503.005, Insurance Code; and
- (b) not be subject to any notice or perfection obligation other than as may be required by Chapter 53, Property Code.

Sec. 162.0064. NONPAYMENT NOT A DEFENSE. Nonpayment by the owner is not a defense for the surety under a bond furnished under Section 162.0062(d).

No equivalent provision.

SECTION 5. Chapter 162, Property Code, is amended by adding Section 162.008 to read as follows:

Sec. 162.008. MANAGEMENT OF CONSTRUCTION TRUST FUND ACCOUNTS. (a) If a property owner required to maintain a construction trust fund account under Section 162.0061 opens and maintains a separate construction trust fund account with the financial institution for each project subject to this subchapter, the periodic statement received from the financial institution must:

- (1) refer to the account as a "construction trust fund" account; and
- (2) identify the project for which the construction trust fund account is maintained.

(b) If a property owner required to maintain a construction trust fund account opens and maintains a construction trust fund account with the financial institution into which funds for two or more projects subject to this subchapter are deposited:

- (1) must be executed by:
- (A) the contractor as principal if furnished under Section 162.0062(b) or by the owner as principal if furnished under Section 162.0062(c); and
 - (B) a corporate surety authorized to execute surety bonds in this state, as provided by Subchapter A, Chapter 3503, Insurance Code; and
- (2) may not be subject to any notice or perfection obligation other than as required by Chapter 53.

No equivalent provision.

Sec. 162.0064. LIMITATION ON ACTION ON BOND. A suit may not be filed on a bond furnished under Section 162.0062(c) after the first anniversary of the later of:

- (1) the date of completion of the contract between the owner and contractor; or
- (2) the date on which retainage is due to the contractor.

Sec. 162.008. MANAGEMENT OF CONSTRUCTION TRUST FUND ACCOUNTS. (a) If a property owner required to maintain a construction trust fund account under Section 162.0061 opens and maintains a separate construction trust fund account with the financial institution for each project subject to this subchapter, the periodic statement received from the financial institution must:

- (1) refer to the account as a "construction trust fund" account; and
- (2) identify the project for which the construction trust fund account is maintained.

(b) If a property owner required to maintain a construction trust fund account opens and maintains a construction trust fund account with the financial institution into which funds for two or more projects subject to this subchapter are deposited:

(1) the periodic statement received from the financial institution must refer to the account as a "construction trust fund" account; and

(2) the owner shall maintain an account record for the construction trust fund account that provides information relating to:

(A) the amount of the funds in the account for each project and the date the funds were deposited;

(B) the date and amount of each disbursement from the account and the person to whom the funds were disbursed; and

(C) the current balance of the account.

(c) For each construction trust fund account maintained by the property owner under Subsection (b), the owner shall maintain the account record for each construction project for which trust funds have been deposited.

(d) Not later than the 14th day after a property owner receives a written request from a person who is a beneficiary of trust funds the property owner shall provide the beneficiary with:

(1) a copy of the periodic statement received from the financial institution regarding the construction trust fund account into which the trust funds of which the person is a beneficiary have been deposited or the original of an executed authorization sufficient to allow the requesting person to obtain the periodic statement; and

(2) the account record required to be maintained by the owner with respect to the construction project for which the trust funds have been deposited.

(e) If a property owner does not provide the notice in the time required by Subsection (d), or if the statement or record furnished does not demonstrate that the owner has complied with the obligations of Section 162.0061 or 162.0062, a beneficiary may suspend contractually required performance

(1) the periodic statement received from the financial institution must refer to the account as a "construction trust fund" account; and

(2) the owner shall maintain an account record for the construction trust fund account that provides information relating to:

(A) the amount of the funds in the account for each project and the date the funds were deposited;

(B) the date and amount of each disbursement from the account and the person to whom the funds were disbursed; and

(C) the current balance of the account.

(c) For each construction trust fund account maintained by the property owner under Subsection (b), the owner shall maintain the account record for each construction project for which trust funds have been deposited.

Sec. 162.009. DISCLOSURES TO BENEFICIARIES; SUSPENSION OF PERFORMANCE. (a) Not later than the 14th day after a property owner receives a written request from a person who is a beneficiary of trust funds, the property owner shall provide the beneficiary with:

(1) if the owner is maintaining a construction trust fund account under Section 162.0061:

(A) a copy of the periodic statement received from the financial institution regarding the construction trust fund account into which the trust funds of which the person is a beneficiary have been deposited or an original executed authorization sufficient to allow the requesting person to obtain the periodic statement; and

(B) the account record required to be maintained by the owner with respect to the construction project for which the trust funds have been deposited; or

(2) if a bond has been obtained or furnished under Section 162.0062, proof of a bond complying with that section.

(b) If a property owner does not comply with Subsection (a) or the information provided under that subsection does not demonstrate that the owner has complied with Section 162.0061 or 162.0062, a beneficiary may suspend contractually required performance the 10th day after the

the 10th day after the date the beneficiary gives the owner written notice that states the intent of the beneficiary to suspend performance and the reason for suspending performance.

(f) An owner may cure any grounds for suspension as provided by Subsection (e) by complying with the requirements of Sections 162.0061 or 162.0062-162.0063 and furnishing proof of such compliance to a beneficiary who has given notice under Subsection (d) or (e).

(g) A beneficiary that has suspended performance as provided by Subsection (e) is not:

(1) required to supply further labor, services, or materials until the owner has cured as provided by Subsection (f) and paid the beneficiary its costs for demobilization and remobilization; or

(2) responsible for damages resulting from suspending work unless the beneficiary continues to suspend performance after the 10th day after the owner has cured under Subsections (f) and (g)(1).

SECTION 6. Section 162.031 (b), (c) and (d), Property Code, is amended.

SECTION 7. The change in law made by this Act applies only to an amount retained under a contract between an owner and contractor entered into on or after the effective date of this Act. An amount retained under a contract between an owner and contractor entered into before the effective date of this Act is governed by the law as it existed immediately before that date, and that law is continued in effect for that purpose.

SECTION 8. This Act takes effect September 1, 2013.

date the beneficiary gives the owner written notice that states the intent of the beneficiary to suspend performance and the reason for suspending performance if the owner does not cure the grounds for suspension under Subsection (c) before the beneficiary suspends performance.

(c) An owner may cure any grounds for a suspension under Subsection (b) by complying with Section 162.0061 or 162.0062 and providing proof of that compliance to the beneficiary.

(d) A beneficiary that has suspended performance under Subsection (b) is not:

(1) required to supply further labor, services, or materials before the date the owner cures the grounds for suspension as provided by Subsection (c) and pays the beneficiary's costs for suspending performance and for resuming performance; or

(2) responsible for damages resulting from suspending performance, unless the beneficiary continues to suspend performance after the 10th day after the date the owner cured the grounds for suspension as provided by Subsection (c) and paid the beneficiary for the costs described by Subdivision (1).

SECTION 6. Substantially the same as introduced version.

SECTION 7. The change in law made by this Act applies only to an original construction contract entered into on or after the effective date of this Act. An original construction contract entered into before the effective date of this Act is governed by the law as it existed immediately before that date, and that law is continued in effect for that purpose.

SECTION 8. Same as introduced version.