

REPORT OF TENNESSEE BAR ASSOCIATION SPECIAL COMMITTEE ON
MECHANICS' AND MATERIALMEN'S LIEN LAW JANUARY 4, 2005

I. Task of the Special Committee.

This Special Committee was formed to review the current mechanics' and materialmen's lien law (Tenn. Code Ann. §§66-11-101, et seq.) and recommend suggestions for improvement. The Special Committee was formed out of a widespread belief that the current law is antiquated, overly difficult to follow, and ineffective.

II. Members of the Special Committee.

The Special Committee is comprised of the following members: Senator Joseph M. Haynes, Representative DeWayne Bunch, Todd E. Panther, Stephen C. Barton, Gregory L. Cashion, Nicholas A. Della Volpe, Christopher S. Dunn, Scott A. Frick, Joseph T. Getz, L. Wearen Hughes, Reggie E. Keaton, David K. Taylor, and R. Loy Waldrop, Jr. The Committee is greatly assisted by Professor Kevin H. Smith of the University of Memphis School of Law who is serving as the reporter for the Special Committee.

III. Problems with Current Lien Law.

The Special Committee broke into subcommittees to identify areas in the current Lien Law that needed to be addressed. The topics listed below are the areas the Special Committee determined needed to be considered:

A. What is lienable?

1. Clarify no liens on public property.
2. Clarify/spell out requirements for lien on landlord's interests when contractor dealing with tenant.
3. Clarify lienor's rights regarding materials and repossession rights.
4. Clarify when claimant has lien rights when materials not incorporated and/or delivered to site.
5. Clarify whether temporary items (supplying utilities, etc.) give rise to lien.
6. Clarify whether lien includes interest and attorney's fees.
7. Is overhead and profit lienable?
8. Are expendable tools lienable?
9. Clarify whether items such as change orders and delay damages are lienable.
10. Clarify when manufacturers are entitled to lien rights (i.e. specially fabricated products, products specifically identified to a site, products not specially fabricated or specifically identified to a site).

B. Who is entitled to lien?

1. Clarify whether an architect/engineer has lien rights if the project is not built.
2. Clarify whether those performing services that do not constitute "visible commencement of operations" have lien rights.
3. Clarify whether a materialman who supplies to a materialman has lien rights (old case says no).
4. Consider doing away with "special contract" requirement for lien.
5. Clarify whether anyone who contracts directly with the owner on residential property has lien rights.
6. Clearly delineate between subcontractor and general contractor.
7. Remove use of names as basis for determining lien rights; focus on those having direct contract with the owner and those who do not.
8. Clarify how many tiers below the general contractor have lien rights.
9. Should subcontractor/supplier be deemed to have a lien upon the general contractor's fulfillment of the lien requirements?
10. Are construction managers who provide no demonstrable improvements to the property entitled to a lien?
11. Clarify priority for all lien claimants.
12. Clarify "owner or owner's agent" language of 66-11-102.

C. Perfection/Notice

1. Consider having one statute or statutory scheme dealing with those who contract directly with the owner and another for those who do not.
2. Make clear to whom all notices must be given (clarify who is the "owner").
3. Should all notices required be deliverable in the same fashion(s)?
4. Clarify whether notices must be mailed or received within relevant time period.
5. Regarding notices of nonpayment:
 - a. Is the time period appropriate/should notice of nonpayment be given before notice of lien?
 - b. Clarify whether one or more than one notice need to be given.
 - c. Revise/clarify contents of the notice (include amount owed, clarify what description of property is needed).
 - d. Should it be by certified mail only?
6. Consider deleting or incorporating/giving teeth to the "consumer" provisions.
7. Regarding the notice of lien:
 - a. Clarify contents (e.g. whether "legal description" is required and, if not, what is sufficient).
 - b. Should there be two windows for giving the notice?
 - c. Should a notice given in the "gap" be invalid?
 - d. Clarify what triggers the beginning of each notice period.
 - e. Clarify "owner" or the person(s) to whom notice must be given.

8. Make it clear that a notice of nonpayment must be a different document than a notice of lien.
9. With respect to recording for constructive notice to third-parties:
 - a. Should there be two periods for doing this?
 - b. Does filing suit alleviate the necessity for recordation?
10. Should recording the contract remain an option?
11. Clarify whether contractual provisions such as a "pay when paid" clause override or toll the notice requirements.
12. Provide mechanism for subcontractor's/suppliers to obtain information needed to perfect lien.
13. Eliminate 66-11-108 enabling lien claimants to take priority over mortgagees.
14. Clarify relation-back provisions of 66-11-119.
15. Include sample notice of nonpayment, notice of lien, notice of completion.

D. Enforcement

1. Should an attachment be necessary?
2. If so, clarify whether it needs to be "issued" or "levied" within the required time; if the latter, clarify "levied."
3. If attachment is required, clarify bond amount.
4. Should someone contracting directly with the owner have longer period to sue?
5. Clarify when the time period for filing suit begins.
6. Retainage:
 - a. Why is it addressed in the lien statute?
 - b. Clarify whether it must be in an interest bearing account.
 - c. Consider clarifying the owner's rights with respect to the retainage.
 - d. Consider allowing the parties to waive the escrow requirement.
 - e. Consider including a penalty or specific enforcement rights if statute is not followed.
7. Clarify who must be named in the litigation.

E. Defenses

1. Clarify how the contract amount and/or prior payments by the owner limit lien rights.
2. As to a notice of completion:
 - a. Clarify when the project is "completed" for the purposes of filing a notice of completion.
 - b. Clarify whether a notice of completion applies to those contracting directly with the owner.
 - c. Clarify the contents of the notice of completion.
3. Regarding the demand for enforcement remedy, consider allowing it to be served in other fashions.
4. As to the bond to discharge lien:

- a. Concerning the option of filing payment bond, consider loosening the requirements for the bond to make more bonds allowable for filing.
- b. Clarify the effect of filing a bond; for example, does a lienor still need to follow all of the requirements and time periods that a lienor otherwise would have to follow?
5. Consider including provision that lien goes away and title cleared if required steps not followed by lienor.
6. Remove consumer protection provisions from lien statute.
7. Remove Prompt Pay Act and interest on retainage provisions from lien statute.
8. Should a lien release/waiver given in reliance upon payment be voidable upon subsequent failure to make payment?
9. Clarify meaning of 66-11-120's limitation of liens to contract price.
10. Bolster 66-11-139's prohibition of exaggerating lien amount (i.e. stated penalties for failing to prove lien within a certain percentage in a rebuttable presumption of exaggeration).
11. Clarify the requirements for "bonding-off" the lien.
12. Revival of lien for failure to keep bond in good standing.
13. Include more understandable provisions allowing the filing of a payment bond.
14. Should one be required to send a notice of completion to potential lien claimants?
15. Include safeguards to protect owners who have made payment from downstream claimants.
16. Should there be a general recourse bond requirement?
17. Give practical effect to 66-11-203, Notice to Owner.
18. Effect of lien/protections for subsequent purchases.

V. Executing the Special Committee's Objectives.

After considering the adoption of specific amendments to the current Lien Law, the Special Committee deemed it best to propose a wholesale replacement of the current Lien Law with a revised, fully-integrated proposed Act. The Special Committee came to this decision based upon the belief that there would need to be too many specific amendments to address the areas the Committee determined should be addressed and the high probability that individual amendments could not be effectively woven into the existing Lien Law without conflict and inconsistency.

Although the Special Committee determined that a wholesale revision of the current Lien Law was required, it also determined that it should adhere to existing policy. For instance, while the Special Committee found no legal basis to distinguish between liens on residential and commercial property, the Special Committee retained this distinction because the Legislature has already made the policy determination that liens on residential real property should be treated differently from liens on commercial property.

The Tennessee Construction Lien Act ("Act") establishes a simple and efficient procedure for creating construction liens by, and for satisfying the claims of, prime contractors and remote contractors who provide work or labor upon or furnish material in furtherance of an improvement if they are not paid.

If adopted, the proposed Act will supersede the provisions of Tennessee law dealing with mechanic's and materialman's liens found at T.C.A. §66-11-101 et seq. The Act is intended to provide a comprehensive scheme for the regulation of construction liens with respect to non-governmental real property.

The Act, it will be noted, is titled "Tennessee Construction Lien Act." This title, suggested by the Uniform Construction Lien Act, is adopted because the use of "Mechanic's Lien" in the title improperly would imply that laborers are the primary beneficiaries of the Act. Given the current practice by contractors of paying wages weekly or bi-weekly, claims for wages no longer represent a significant portion of construction lien claims.

Although the Act is based primarily on the Ohio Mechanic's Lien Act, the Special Committee offers no opinion concerning the role of specific Ohio judicial precedents in interpreting and applying the Act. In addition, the Special Committee offers no opinion concerning the role of specific precedents in interpreting and applying those portions of the Act drawn from the Uniform Construction Lien Act and from the Uniform Commercial Code. The Special Committee believes that the role of such precedents is a matter best left to the sound discretion of the Tennessee courts on a case-by-case basis.

The Act provides for a statutory construction lien against real estate being improved by persons who supply work, labor, or materials for the improvement. As a general rule, a lien is allowed to any person with the necessary contractual relationship who furnishes work, labor, or materials for the improvement regardless of how far he is removed from the contracting owner. No inflexible limitation is placed on a person's ability to obtain a construction lien based on how many "tiers" removed the lien claimant is from the contracting owner. Thus, the lien claimant and the contracting owner do not need to have a direct contractual relationship; indeed, a valid construction lien may arise even though the contracting owner has no prior knowledge of the lien claimant, much less any knowledge of the nature, extent, and cost of the work, labor, or material provided by the lien claimant.

The Act allows a construction lien to suppliers of materials only when they have in some way indicated that they sell with the belief that the materials are to be used on the particular real estate improvement project. Therefore, a material supplier who delivers materials to a prime contractor without knowing the particular real estate on which the materials are to be used may not later claim a construction lien on the real estate on which the materials actually were used. Many existing construction lien statutes provide a construction lien to a material supplier only if the materials are delivered to the site. The Act relaxes that requirement somewhat and allows a

construction lien if the seller's belief that the goods are to be used on a particular site is evidenced by a notation on the sales contract or by a delivery order, as well as by actual delivery to the site. However, except with respect to materials specially fabricated for the particular real estate improvement project and not salable in the ordinary course of the material supplier's business, a material supplier may not obtain a construction lien unless the materials actually are used in furtherance of the improvement. A construction lien is given to persons who supply materials such as gasoline, which are consumed in the course of the improvement, and also to lessors of machinery and tools used in furtherance of the improvement. The requirement of actual use is ameliorated somewhat by the creation of a rebuttable presumption that materials delivered to the site were incorporated into the improvement, consumed as normal wastage in the course of the improvement, or used in a manner reasonably necessary for the construction of the project.

Surveyors, architects, and engineers who perform land surveys or prepare architectural or engineering plans are allowed a construction lien under the Act, thus continuing the existing practice. The Act does not create or authorize a so-called "broker's lien" for work performed by a broker or agent in connection with the identification of property or clients, preparation of property for purchase, sale, or lease, or any action involved with or connected to a purchase, sale, or lease of property or an improvement thereon. Finally, the Act does not cover public construction projects.

The Act adopts a notice recording device, first developed in Florida, under which the contracting owner, prior to the beginning of work on an improvement, records a "notice of commencement" which puts third parties on notice that construction liens may be claimed against the real estate. If a lien claimant timely takes the other steps set out in this Act, his priority date is the date on which the notice of commencement was recorded.

By adopting a notice recording device, the Act deviates from the existing mechanic's lien law in Tennessee that dates a lien claimant's priority from the time of "visible commencement of operations" (see 66-11-104(a) of the Tennessee Code). A priority rule based on the visible commencement of operations makes it difficult for persons who deal with real estate to determine whether it may be subject to subsequently asserted construction lien claims since a record title examination will not provide the necessary information. In effect, a priority rule based on the visible commencement of operations gives the lien claimant a secret construction lien. The secret construction lien is of limited duration since a claimant is required to record a notice of the lien within a fairly short period of time if he is to realize on the lien. Nevertheless, the title difficulties created by a visible-commencement-of-operations rule may be substantial.

A priority rule based on the visible commencement of operations also may create difficulties for construction lenders. A construction lender usually records his mortgage at about the time the work is beginning. And, with some regularity, a construction lender will discover that work had commenced prior to the time he recorded, so that he is junior

to the construction lien claimant. Under the visible-commencement-of-operations priority rule, a careful construction lender makes an on-site inspection prior to recording any mortgage and makes an effort to preserve evidence that no work had commenced before the mortgage was recorded. Such efforts involve additional expense and do not guarantee that a court will later agree that recording by the mortgagee predated visible commencement of operations.

The Act adopts the “notice of commencement” as a notice recording device to place third parties on notice that construction liens may be claimed against the real estate. If a construction lien claimant records his lien during the effective period of a notice of commencement, his priority date is the date on which the notice of commencement was recorded. The notice of commencement, somewhat like a Uniform Commercial Code Article 9 financing statement, need not describe the proposed improvement in minute detail. In general, the notice of commencement protects any person who furnishes work, labor, or materials in furtherance of the described improvement. The goals of providing a simple and inexpensive procedure are furthered by the use of a safe-harbor notice of commencement form that does not require extensive details and that may be completed quickly.

A notice of commencement does not automatically cease to be effective after either a time stated in the notice of commencement or a time fixed by statute. In this respect the Tennessee Construction Lien Act differs from the Uniform Construction Lien Act, which provides that the notice of commencement is effective for the time stated in the notice (but at least six months) or, if no time is stated in the notice, for three years, except that the notice is effective for only one year as against a protected party buyer of residential real estate. The effective length of a notice of commencement may be relevant if two or more notices of commencement are filed with respect to the same real property. The Special Committee believes, however, that the interests of all parties can adequately be protected (1) through a careful comparison of the scope of each of the multiple notices of commencement or (2) by having the owner complete the procedure necessary to terminate one of the notices of commencement, either in whole or in part.

If a notice of commencement is not recorded, lien claimants take priority from visible commencement of operations.

The notice-of-commencement system permits third parties to rely on the record and, at the same time, gives all claimants on a particular improvement the same effective date no matter how many prime contractors there are and no matter when the particular lien claimant comes on the job.

Particularly in smaller, owner-financed improvements, it may be uneconomical to record a notice of commencement, and, in such cases, as already noted, lien claimants are protected by giving them a visible commencement effective date. The Act seeks to encourage owners to record a notice of commencement even with respect to smaller, owner-financed improvements by providing a simple-to-complete, standard form.

The Act follows prior Tennessee practice—as well as the practice in practically all states—by denying to construction liens a priority over prior-recorded mortgages.

VI. Short-term Upcoming Events.

As of the drafting of this summary, the Special Committee is finalizing its proposed draft of the Act. Once completed, the Special Committee has identified a number of trade groups to whom it will send the proposed legislation for review and comment. It is the belief of the Special Committee that this “vetting” of the proposed Act is indispensable to secure widespread support for the proposed Act and to avoid fighting among the various trade groups who will be affected by the Act. It is the hope of the Special Committee that all of the trade groups affected by the Act will agree to support the proposed legislation so that it may be presented to the Legislature with the assurance that the Tennessee Bar Association and the major trade associations are all in support of it.