Mechanics' Liens—An Owner Must Retain Ten Per Cent of the Cost of the Building Under Article 5469 of the Hardeman Act. *Hayek v. Western Steel Co.*, 469 S.W.2d 206 (Tex. Civ. App.—Corpus Christi 1971, writ filed).

E. W. Hayek, preparing to construct a building upon his land, contracted with Glenn McEntire, an independent contractor, for the concrete foundation. McEntire purchased the steel and concrete materials from Western Steel Co. but left an unpaid balance of $20,002. Western Steel Co. subsequently brought suit seeking a personal judgment against Hayek and a foreclosure of its statutory materialman's lien against the affected land. The trial resulted in a judgment for plaintiff and foreclosure of its materialman's lien in the amount of $20,002. The Corpus Christi Court of Civil Appeals affirmed the trial court's decision holding that a landowner must retain ten percent of the total cost of the building and is liable up to that amount if he fails to retain these funds.[1]

Historically, the Texas constitution authorized protection for mechanics, artisans, and materialmen,[2] and prior to 1961, various Texas legislatures passed statutes establishing these liens. In 1961, several changes were made by enacting a comprehensive act embodying all of these statutes rather than by amending or repealing each statute with a separate bill.[3] The purpose of the legislature in enacting the present mechanics' and materialmen's lien law was to prevent the loss of liens through technicalities.[4]

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1. Hayek v. Western Steel Co., 469 S.W.2d 206 (Tex. Civ. App.—Corpus Christi 1971, writ filed).

2. TEX. CONST. art. XVI, § 37. This article provides:
Mechanics, artisans and materialmen of every class, shall have a lien upon the buildings and articles made or repaired by them for the value of their labor done thereon, or material furnished therefor: and the legislature shall provide by law for the speedy and efficient enforcement of said liens.

3. Tex. Laws 1961, ch. 382, at 863:
An act . . . amending Articles 5452, 5453, 5454, 5455, 5456, 5463, 5467, 5468 and 5469 of Title 90 of the Revised Civil Statutes of Texas, 1925; repealing Articles 5457, 5461, 5462 and 5465 of Title 90 of the Revised Civil Statutes of Texas, 1925; . . . .
This act is commonly referred to as the Hardeman Act in view of its sponsorship in the Senate by the Hon. Dorsey B. Hardeman of San Angelo.

4. Tex. Laws 1961, ch. 382 § 14, at 872:
The fact that the existing Statutes governing mechanics' and materialmen's liens are antiquated, vague and ambiguous and have been the subject of numerous conflicting court decisions resulting in loss of liens through technicalities, creates an emergency . . . .

Prior to the 1961 amendment, article 5469 stated in part:

> Whenever any mechanic or artisan shall perform any labor or service for any contractor, . . . in the erection or repair of any . . . building, . . . such owner, . . . shall retain in his hands during the progress of such work and for thirty days after the completion thereof, to secure the payment of said artisans and mechanics, *ten per cent of the contract price of such building . . . . All mechanics* or *artisans . . . shall have . . . a preference lien* upon said fund so retained in the hands of such owner, ... If such owner, . . . refuses or fails to comply with the provisions of this law, the mechanics and artisans . . . shall have . . . preference liens, . . . as against the house or building . . . to secure payment of such liens.[5]

In 1961, this portion of article 5469 was amended to read:

> Whenever work is done whereby a lien may be claimed under Article 5452 hereof, it shall be the duty of the owner, . . . to retain in his hands during the progress of such work and for thirty (30) days after the work is completed, to secure the payment of artisans and mechanics who perform labor or service, and to secure the payment of any other claimants furnishing material, . . . *ten per cent of the contract price to the owner, ... All persons who shall send notices* in the time and manner required by this Act . . . *shall have a lien* upon the fund so retained by the owner . . . with preference to artisans and mechanics, . . . with any remaining balance to be shared ratably among all other participating claimants. If the owner, . . . refuses or fails to comply with the provisions of this Article, then all claimants . . . shall share ratably among themselves, with preference to artisans and mechanics . . ., liens at least to the extent of the aforesaid fund of ten per cent (10%) which should have been retained, as against the house, building, structure or improvement . . . to secure payment of such liens.[6]

The amendment increased the scope of the present statute to include materialmen as well as mechanics and artisans. But the new statute gives mechanics and artisans priority over the materialmen to the ten per cent retainage fund. The amended article also changed the phrase describing the amount to be retained by the owner from "ten per cent of the contract price of the building" to "ten per cent of the contract price to the owner."

5. Tex. Laws 1909, ch. 103, § 1, at 184 (emphasis added).
6. TEX. REV. CIV. STAT. ANN. art. 5469 (Supp. 1970-1971) (emphasis added).

Under the amended statute however if the owner enters into a separate contract for each part of the project (one contract for the foundation with *K*1, a separate contract for the building with *K*2, and a third contract for heating, plumbing, and air conditioning with *K*3)[7] the question has arisen whether the owner is required to retain (a) ten percent of *each separate contract* for the exclusive benefit of the laborers or materialmen performing under that particular contract or (b) ten percent of the *total cost* of the *building* for the benefit of all laborers and materialmen under any of the contracts, without regard to the particular contract under which the labor and materials were furnished.[8] In answering this question a conflict has arisen in the decisions of the courts of civil appeals. The Austin Court of Civil Appeals held that the requirement to retain ten percent of the contract price is not determined by the construction price of the building but is limited to ten percent of each separate contract.[9] In referring to the language change in article 5469 they said, "This change, clear to us, is that the amount of required retainage is no longer necessarily measured by the contract price of the building but is measured by the contract price, one or more to the owner."[10]

Citing the Austin court's decision, Hayek contended that article 5469 limited his liability to ten percent of the $49,581 contract with McEntire for the foundation. The *Hayek* court rejected this contention and held that Hayek's liability was up to ten percent of the cost of the $500,347 building. The court reasoned that the legislature did not intend to restrict mechanics and materialmen to only ten percent of each contract because this would be inconsistent with practices prior and subsequent to the amendment of article 5469. Mechanics and artisans were allowed up to ten percent of the cost of the building under the statute prior to the amendment,[11] and the result is the same under the amended statute when the owner contracts with a general contractor and there is only one contract for the entire project.[12]

The court further reasoned that the protection for the laborers and

7. Throughout the remainder of this note, the author will use the following symbols to designate various parties in hypothetical situations: *O*—owner, *K*1—contractor under contract number 1, *M*1—materialman furnishing material under contract number 1.

8. Hayek v. Western Steel Co., 469 S.W.2d 206 (Tex. Civ. App.—Corpus Christi 1971, writ filed).

9. Lennox Indus., Inc. v. Phi Kappa Sigma Educ. & Bldg. Ass'n, 430 S.W.2d 404 (Tex. Civ. App.—Austin 1968, no writ).

10. *Id.* at 408.

11. Miller v. Harmon, 46 S.W.2d 342 (Tex. Civ. App.—Austin 1932, writ dism'd).

12. There is no controversy between the courts over the amount to be retained by the owner when he enters into a general contract for the total construction because ten per cent of the cost of the building and ten percent of the contract to the owner are equal amounts of money.

materialmen is inadequate if the owner enters into separate contracts and only retains ten percent of each contract. Hayek's liability would be only $4,958,[13] which would be insufficient to cover the $20,002 claim of the materialman. However, if his liability is ten percent of the total construction price, then his liability is over $50,000,[14] which would be sufficient to protect the materialman.

The *Hayek* decision, establishing the owner's liability at ten percent of the cost of the building rather than ten percent of the cost of the contract, might seem to place an excessive penalty on the owner for failure to retain ten percent of each contract. But, the court points out that the owner has the power to protect himself from liability, not only by properly retaining the funds required by article 5469, but also by requiring that the contractor furnish a payment bond.[15] This provides protection for both the owner and the claimants, and the option of requiring the contractor to furnish the performance bond rests only with the owner. The *Hayek* court reasoned that because the laborers and materialmen do not have the power to demand the protection of the bond, their protection lies in the funds retained by the owner. Therefore, because of its protective function the statute should be construed liberally to afford the greatest protection for mechanics and materialmen.[16]

The *Hayek* court also noted that they had previously construed article 5469, as amended, to establish the owner's liability at ten percent of the cost of the building.[17]

The decision of the court in the present case seems sound when the owner *fails to retain* the ten percent fund. But, it is questionable whether

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13. Ten per cent of the $49,581 contract for the foundation.

14. Ten per cent of $500,346 which was the total cost of the building.

15. TEX. REV. CIV. STAT. ANN. art. 5472d (Supp. 1970-1971). It should be noted that this is not a mandatory requirement.

16. General Air Conditioning Co. v. Third Ward Church of Christ, 426 S.W.2d 541 (Tex. 1968) (Owner failed to retain the required funds for thirty days after the work was completed but the materialman did not perfect his lien until forty-four days after the work was completed. The court held the owner liable, however, because notices prescribed by article 5453 were received by the owner and claimant's lien had been secured in accordance with article 5453.); *see* University Sav. & Loan Ass'n v. Security Lumber Co., 423 S.W.2d 287 (Tex. 1967).

17. Hunt Developers Inc. v. Western Steel Co., 409 S.W.2d 443 (Tex. Civ. App.—Corpus Christi 1966, no writ). This decision was based on a statement by the Texas Supreme Court that, "It [article 5469] requires an owner to retain ten percent of the contract price of the building for thirty days after completion . . . ." Lane-Wells Co. v. Continental-Emsco Co., 397 S.W.2d 217, 220 (Tex. 1965). However, the question before the court in the *Lane* case was not the construction of article 5469, but was whether or not article 5469 had any application to priority of liens available to laborers and materialmen in the oil and gas industry arising under article 5473. Article 5473 contains no provision requiring the owner to retain funds. The court said article 5469 deals with priorities and not the enforcement of liens and has no application to article 5473.

it would serve as a sound basis when applied to a situation where the owner executes separate contracts for various phases of the construction *and retains* ten percent of all the contracts.

To illustrate this situation, suppose *O* contracts with *K*1 to construct the foundation for his building for $10,000, then initiates separate contracts with *K*2 to build the building for $60,000, and *K*3 to furnish and install the heating, plumbing, and air conditioning for $30,000. Following *Hayek* the owner pays each contractor up to ninety percent of the contract but must retain ten percent of each contract to establish a fund equal to ten percent of the cost of the building. This retainage fund would include $1,000 from *K*1, $6,000 from *K*2, and $3,000 from *K*3 for a total of $10,000. Then suppose that at the end of the thirty day waiting period *M*3 has properly perfected a $10,000 claim for materials furnished *K*3. According to *Hayek, M*3 would have a right under article 5469 to share ratably in the fund with *K*1 and *K*2. Thus, the retainage fund is depleted and *O* has paid out one hundred percent of the cost of the contracts. But, any portion of the retainage fund received by *M*3 in excess of the $3,000 withheld by the owner under the contract with *K*3 must necessarily be furnished from the funds retained under the contracts with *K*1 and *K*2. If the owner has properly retained the money in accordance with the statute and paid the claims, theoretically he cannot be held liable for more than the total cost of the building.[18] But, a conflict is created because *O* owes *K*1 and *K*2 a portion of their contracts paid to *M*3 from the retainage fund. This would in effect make *K*1 and *K*2 sureties for *K*3.

There is no conflict if the courts decide that the owner is only liable to the materialman for ten percent of the contract under which the material is furnished. In the hypothetical case he would pay *M*3 the ten percent retained under the contract with *K*3, or $3,000, and pay *K*1 and *K*2 the ten percent remaining due on their contracts. This would seem to be more consistent with usual contracting procedures and with the intent of the parties when the contracts were made.[19] It also gives proper weight to article 5452[20] and article 5454[21] which provides other methods

18. TEX. REV. CIV. STAT. ANN. art. 5463 (Supp. 1970-1971). *See* Trinity Universal Ins. Co., 412 S.W.2d 691 (Tex. Civ. App.—San Antonio 1967, writ ref'd n.r.e.).

19. Personal interview with Mr. R.C. Hodges, Pres., R.C. Hodges Electric, Plainview, Texas. Mr. Hodges stated that when there was no general contractor, the contracts made directly with the owner called for payment of the ten percent retainage thirty days after the work under the contract was completed.

20. TEX. REV. CIV. STAT. ANN. art. 5452, § 2(e) (Supp. 1970-1971). This article provides that there may be more than one original contractor.

21. TEX. REV. CIV. STAT. ANN. art. 5454 (Supp. 1970-1971). Under the provisions of this article the materialman may give notice to the owner to retain any funds which the owner has not paid to the contractor. This gives the materialman protection for any materials not paid for by the contractor during the progress of the construction.

for the materialman to require the owner to retain funds for payment of materials furnished.

Limiting the owner's liability to ten percent of the cost of the contract also provides adequate protection for artisans, mechanics and materialmen at the time it is needed most. Laborers and artisans are usually paid weekly[22] and ten percent of the contract price would be more than such claims. The artisans and laborers need this protection during the last stages of the contract because if the contractor fails to pay them at any other stage of the work he would not have any workers left to complete it. The materialman would also be protected if the contractor fails to pay for materials furnished during the last stages of construction and there is no opportunity for the materialman to perfect his lien under article 5453.[23] Thus, the purpose of the statute, protecting mechanics, artisans, and materialmen when they are most vulnerable to loss, would be fulfilled.

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22. Interview with Mr. Hodges note 18 *supra*.
23. TEX. REV. CIV. STAT. ANN. art. 5453 (Supp. 1970-1971).