

Approved by the Judicial Council December 3, 2010

**REPORT OF THE JUDICIAL COUNCIL LIEN LAW
ADVISORY COMMITTEE ON 2010 SB 469**

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INTRODUCTION

In March 2010, the Senate Judiciary Committee voted to refer 2010 SB 469 to the Judicial Council for study. The bill would create a state construction registry including new notice requirements for subcontractors and suppliers in commercial construction projects. The bill was generally supported by general contractors but opposed by subcontractors and suppliers. Senate Judiciary Chair Tim Owens asked the Council to “recommend a fair and equitable compromise.” At the time the Senate Judiciary Committee referred the bill to the Council, Senator Owens also requested that the Council undertake a recodification of Kansas lien laws.

The Judicial Council agreed to undertake both the study of SB 469 and the recodification of the state’s lien laws. The Council formed a new Lien Law Advisory Committee to complete both tasks.

COMMITTEE MEMBERSHIP

The members of the Lien Law Advisory Committee are:

Joe Jeter, Chair, Hays; practicing attorney and member of the Judicial Council.

Bennie Crossland, Columbus; President of Crossland Construction Company, Inc., National Director of Associated General Contractors of America, and Board Member of Associated General Contractors of Kansas.

Brian Dietz, Kansas City, MO; Associate Counsel for JE Dunn Construction Company.

Hon. Charles Droege, Olathe; District Court Judge in the 10th Judicial District.

Rep. John C. Grange, El Dorado; State Representative from the 75th District, and Owner of Carlisle Heating and Air Conditioning.

William Miller, Olathe; President of Building Erection Services Company and Member of the American Sub-Contractors Association.

Diane Minear, Tonganoxie; Legal Counsel for the Secretary of State.

Woody Moses, Topeka; Managing Director of the Kansas Aggregate Producers' Association and the Kansas Ready Mixed Concrete Association.

Kathy Olsen, Topeka; Senior Vice President and General Counsel of the Kansas Bankers Association.

Hon. John K. Pearson, Lawrence; practicing attorney, Adjunct Professor at the University of Kansas School of Law, and Retired U.S. Bankruptcy Judge.

Bob Totten, Topeka; Public Affairs Director for the Kansas Contractors Association.

Tom Tunnell, Topeka; President and CEO of the Kansas Grain and Feed Association and the Kansas Agribusiness Retailers Association.

Sen. John Vratil, Overland Park; State Senator from the 11th District.

DISCUSSION

The Lien Law Advisory Committee met in September and October 2010 to study SB 469. The Committee reviewed the bill (see attached copy) and the written testimony of proponents and opponents offered during a hearing on the bill in the Senate Judiciary Committee on March 3, 2010. Committee members discussed the pros and cons of the bill from the perspective of the various parties involved and whether any compromise could be reached.

Summary of the bill:

Senate Bill 469 would establish a state construction registry to be implemented and maintained by the Secretary of State. The purpose of the registry would be for the filing and maintaining of notifications by general contractors, subcontractors and remote claimants on

commercial construction projects. (The bill does not apply to residential or highway construction.)

Under the bill, a general contractor may file a notice of commencement with the registry for the purpose of notifying other persons such as subcontractors and remote claimants about the construction project. Although filing a notice of commencement is not mandatory, to be effective, it must be filed within 15 days of commencement of physical construction work at the project site.

If a general contractor chooses to file a notice of commencement on a project, then any subcontractor or remote claimant who has provided labor, equipment or materials must file a notice of furnishing with the registry in order to preserve their lien rights. Filing of a one-time notice of furnishing is mandatory and must occur within 21 days of the date of furnishing of labor, equipment or materials. If the subcontractor or remote claimant files at a later date, their lien rights will only be effective as to the value of labor, equipment or materials provided after that date.

Proponents:

SB 469 was supported by the Associated General Contractors of Kansas as a solution to the perceived problem of general contractors who bear the risk when a subcontractor fails to pay remote claimants (second tier subcontractors and suppliers who have no direct relationship with the general contractor). The problem arises, for example, when a general contractor pays a subcontractor, but because the subcontractor's business is failing, the subcontractor does not pay its second tier subcontractors and suppliers. Those remote claimants are then allowed by statute to file a lien or bond claim against the property. The general contractor, who has already paid the subcontractor, has an obligation to deliver a lien-free project to the owner and must then use its own funds to pay the remote claimants for goods and services already paid for once.

General contractors believe that they could avoid this problem by finding out ahead of time who the remote claimants are. Then, if there is a problem with the subcontractor, the general could pay any remote claimants directly or issue a joint check, thereby insuring that all parties get paid and that the general does not become liable for a subcontractor's default. A

state construction registry as contemplated by SB 469 would allow a general contractor to discover who all of the remote claimants are on any given project and make sure they are getting paid.

Opponents:

The bill was opposed by subcontractors and suppliers who believe that it places an undue burden on them. The opponents to the bill argued that the current lien law system is working well and adequately protects all parties without being unduly burdensome. Under the current law, subcontractors and suppliers have three months after labor, equipment materials or supplies are last provided to file a lien statement. K.S.A. 60-1103. Most of the time, subcontractors and suppliers submit their bills to the general contractor or subcontractor within 30 days and are promptly paid. On the rare occasion when payment is not forthcoming, the 3-month period allows sufficient time for the remote claimant to bill the owner or, as a last resort, to file a statutory lien.

Under the bill, remote claimants would be required to file a notice of furnishing within 21 days of providing labor, equipment or materials or lose their lien rights as to the value of that labor, equipment or materials; however, remote claimants indicate they are unlikely to know there is a problem getting paid by a subcontractor for at least 60 days. Opponents of the bill believe that many remote claimants would lose their lien rights under the bill, either because they do not understand the process or because they believe their small bill does not justify the extra hassle of locating the project in the registry and going to the expense and effort to file a notice of furnishing.

Furthermore, suppliers say they do not always know where their materials are being delivered and might not have the necessary information to file a notice of furnishing. Under current law, a supplier does not have to find out where its materials are being used unless it actually becomes necessary to file a lien.

Opponents of the bill also pointed out that subcontractors and suppliers work on many projects each year, and the bill could require them to file thousands of notices to protect their lien rights. This would be costly and time-consuming. Also, because the bill allows but does not require a general contractor to file a notice of commencement, a general might choose to register some projects but not others. This would create uncertainty and require remote

claimants to constantly check the registry to see if a notice of commencement had been filed on any given project.

Although most of the opponents to the bill were remote claimants, the Kansas Contractors Association also opposed the bill on the ground that the problem identified by general contractors (the failure of a subcontractor to pay remote claimants) is a risk allocation issue, and that risk is simply a cost of doing business for general contractors.

Secretary of State's concerns

In addition to considering the arguments of the opponents and proponents of the bill, the Committee reviewed a list of concerns about implementation of the bill from the Secretary of State's office. The Secretary of State's primary concern about the registry was cost and the difficulty of predicting cost. Because the registry contemplated by the bill is discretionary rather than mandatory, it is difficult to predict how many people will use it and how much it will cost to maintain. While other states such as Utah have construction registries, they are not sufficiently comparable to provide a good point of comparison for the purpose of estimating cost. (For example, Utah's registry is mandatory and covers residential as well as commercial construction.) The Secretary of State's office also found the bill to be unclear on many aspects of the filing process such as how filings should be indexed, how corrections to a filing can be made, and how late filings should be treated.

In discussing the cost of building and implementing an electronic registry, there was some indication from general contractors that the Associated General Contractors of Kansas might be willing to help defray some of that cost.

Areas of Compromise

The Committee identified a number of areas of potential compromise. Committee member Bennie Crossland reported that the Associated General Contractors Board would be willing to accept the following amendments to the bill:

- 1) Make it mandatory rather than discretionary for a general contractor to file a notice of commencement. In other words, all commercial construction projects would have to

be registered projects. However, the question remains what the penalty would be for a general contractor who failed to file a notice of commencement.

- 2) Require that the general contractor file a notice of commencement before work begins on a project, rather than within 15 days of when work begins.
- 3) Include a \$5,000 threshold below which a subcontractor or supplier would not be required to file a notice of furnishing.
- 4) AGC would not oppose including residential construction in the bill. However, the Committee agreed it would not recommend such a step without inviting representatives from the residential construction industry to participate in the discussion.

The two biggest areas of concern for general contractors are the time of filing the notice of furnishing and making that filing mandatory. Because of a general contractor's usual 30-day billing cycle, it is important to the general that a second tier subcontractor or supplier file a notice of furnishing within 20 to 30 days of providing labor or materials. If the notice were filed later than that, there would be a substantial risk of a general contractor having already paid its subcontractor.

From the perspective of subcontractors and suppliers, they do not know there is going to be a problem getting paid by the subcontractor until well after 30 days have passed. They would prefer a longer notice filing period such as 90 days.

The subcontractors and suppliers suggested an "incentive system" might represent a possible compromise. Under one example of an incentive system, the filing of a notice of furnishing would be discretionary; however, upon 60 days after filing a notice of furnishing, a subcontractor, sub-subcontractor or supplier could apply for and receive direct payment from the general contractor for any unpaid amounts. The idea behind an incentive system is that remote claimants would not lose their lien rights if they failed to file a notice of furnishing, but they would be encouraged to file a notice of furnishing because of the added benefit of direct payment from the contractor.

Although general contractors believe they would receive no benefit from an entirely discretionary system, the Committee discussed the possibility that such a system might start out

as a discretionary, incentive-based system and later evolve into a mandatory system after interested parties had the time and opportunity to discover the benefits of using the registry.

Committee member Judge Pearson suggested an alternative proposal which might also form the basis for a compromise. He proposed the establishment of a simplified, notice-based filing system using a centralized mechanics lien database. The system would completely replace the existing system for filing mechanics liens, would be centrally maintained by a state agency, and would be accessible online. The system might be tied to the Department of Revenue's existing database using the same property identification number (PIN) or a specially generated construction project number rather than a full legal description.

COMMITTEE CONCLUSION

The Committee agreed that, over the course of two meetings, it had made progress toward a possible compromise on SB 469, although it has not yet reached a consensus. The Committee hopes that it will be able to reach a reasonable compromise on the concept of a state construction registry with continued meetings in 2011. As it continues to discuss the possible components of such a compromise, the Committee has identified the following issues:

- 1) Second tier subcontractors and suppliers might find some benefit in a registry system which allowed them to get paid directly by a contractor and to get paid sooner.
- 2) Second tier subcontractors and suppliers are most concerned about the possibility of losing their lien rights because of failing to file a notice of furnishing.
- 3) General contractors are most concerned about keeping the notice of furnishing mandatory and timely.
- 4) The Committee will need to focus on the public good to be achieved by the concept of a registry.
- 5) The Committee will need to keep in mind cost, technical support and indexing issues.

The Committee will continue to consider these issues as it proceeds with its planned study of the recodification of Kansas lien laws and hopes to make a recommendation about a registry as part of that recodification.