

CONSTRUCTION LAW

Alert

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Recent Changes in Tennessee Construction Law

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During its 2007 session, the Tennessee General Assembly enacted, modified and repealed certain provisions of state law concerning construction payment retainage, construction liens and contractor licenses. These changes to the law are now in effect.

RETAINAGE

In the modified lien law and Prompt Pay Act, the General Assembly changed the requirements for retained payments under a construction contract. Under the Prompt Pay Act, retained amounts must not exceed five percent of the contract price. Under the lien law, any retained amounts (in contracts or subcontracts for \$500,000 or greater) must be deposited in a separate, interest bearing escrow account. Upon deposit into such an account, the funds become the property of the party to which they are owed. This ownership is subject to the rights of the paying party in the event the contractor defaults or fails to complete the contract. The modified lien law also allows parties to contract in advance for the settlement of retainage disputes through arbitration.

The Prompt Pay Act also now requires an owner to release and pay all retainage to the prime contractor within 90 days after completion of the work or 90 days after substantial completion of the project, whichever is earlier. The prime contractor must then pay all retainage owed to subcontractors within 10 days of receiving retainage payment from the owner. These subcontractors must then pay their subcontractors or suppliers within 10 days of receiving their retainage payment.

CONSTRUCTION LIENS

The General Assembly also amended and clarified the requirements for liens associated with improvements to real property. As modified, the lien law removes the previous distinctions between contractors, subcontractors, materialmen and furnishers. Instead, parties with lien rights are categorized according to their contractual relationship with the owner. A party that contracts directly with an owner of real property is considered a "prime contractor." A party that contracts with an entity other than an owner of real property (including land surveyors, licensed engineers and architects) is a "remote contractor."

The law now provides that a lien shall secure the contract price, plus any extras that are included in the contract. If the contract does not include a price, the law allows a lien for the reasonable value of all work, labor, materials, services, equipment, machinery, overhead and profit included in the agreement.

Other changes in the lien law, some of which codify prior judicial decisions, include:

General Provisions

- The provisions of the lien law are to be construed and applied liberally so as to ensure the intended results of the law. These include new provisions that preserve the validity of liens that “substantially comply” with the law; nonprejudicial errors and omissions will not render a lien invalid.
- The names and addresses of any owners and contractors listed in a building permit are presumed to be correct, as is any description of real property stated in the permit.
- Service of any notices on one owner listed in the building permit is sufficient for service on all owners.
- Service of any notices required or permitted under the lien law may be accomplished by registered or certified mail (return receipt requested), hand delivery (evidenced by a sworn statement) or any other commercial delivery service that provides written confirmation of delivery.

Lien Amount

- Liens may not include interest, service charges, late fees, attorney fees or any other amounts that do not result in an improvement to the real property.
- A lienor who is without default and who has been prevented from completely performing may acquire a lien for that portion of the contract price equal to the proportion of the lienor’s work that has been completed.
- The lien amount may include the reasonable rental value for tools, equipment or machinery for the period of actual use, or may include the purchase price of tools, equipment or machinery if they were purchased for use on the particular improvement and have no substantial value to the lienor after completion of the improvement.

Commencement and Cessation of the Improvement

- The “visible commencement of operations” (which establishes the attachment date for liens under the statute) excludes demolition, surveying, excavating, clearing, filling or grading, placement of sewer or drainage lines or other underground utility lines and erection of temporary security fencing. It also excludes the preparation or delivery of materials for these activities.
- An improvement is considered to have been abandoned if operations on the improvement cease for 90 days, rather than 60 days as provided under the prior statute.

Owners

- An owner may prevent remote contractors from having liens on its property by recording a payment bond in favor of the remote contractors equal to 100 percent of the prime contractor’s contract price.

Prime Contractors

- The law states that engineers and architects may acquire a lien only to the extent that the improvements for which their services were provided were actually made.
- A prime contractor's lien continues for one year after the date the improvement is completed or is abandoned and until the final decision of any suit properly brought within that time for its enforcement.

Remote Contractors

- To acquire a lien for work, labor, materials, services, equipment or machinery, a remote contractor must:
 1. Serve a Notice of Nonpayment on the owner and prime contractor with which it has a contract; and
 2. Serve a Notice of Lien, in writing, on the owner of the property on which the improvement is being made any time prior to 90 days after the date of completion or abandonment of the improvement. (This creates a single deadline for remote contractors to serve a Notice of Lien.)
- A remote contractor's lien continues for 90 days from the date of service of the Notice of Lien and until the final termination of any suit properly brought within that time for its enforcement.

Recording Notice of Lien

- Recording an acknowledged or sworn contract by a lienor provides constructive notice to a subsequent purchaser or encumbrancer for valuable consideration of the existence of the lien.
- A Notice of Lien may be recorded anytime prior to 90 days after the date of completion or abandonment of the project. This applies to all lienors.
- The statute now contains a standard form for the Notice of Lien.

Notice of Nonpayment

- A remote contractor must serve a Notice of Nonpayment on the owner and prime contractor within 90 days of each month in which it provided work, labor, materials, services, equipment or machinery to the improvement and for which it intends to claim a lien.
- The statute now contains a standard form for the Notice of Nonpayment.

Project Completion

- On the same date that an owner records a Notice of Completion, it must also serve a copy of the notice on the prime contractor and any remote contractor that has served a Notice of Nonpayment.
- A prime contractor or remote contractor that has been served with a Notice of Completion has 30 days to serve the notice on its remote contractors.

- The statute now contains a standard form for the Notice of Completion.

Enforcement

- A lien enforcement suit seeking the issuance of an attachment is timely if the suit is filed within the applicable period, even if the attachment is not issued or served within the applicable period.
- A plaintiff that makes an application for attachment must execute a bond payable to the defendant in the lesser amount of \$1,000 or the lien claimed.
- An attachment on real property is not necessary if a bond to discharge the lien was provided and recorded before the suit was filed.
- In a suit seeking an attachment or a suit against a bond, the lienor has an obligation to effectively prosecute the suit or pay the defendant's cost of defense.
- When a bond has been posted to discharge a lien, the defendants retain all defenses as to the underlying lien claim.
- If the lien is no longer in effect, the lienor must record a release of lien within 30 days of a written demand or the lienor will be liable for all resulting damages.

Misconduct

- If any amounts remain unpaid on a project of improvement or if an owner has been served with a Notice of Nonpayment that remains unpaid, the owner may not use the proceeds of a construction loan for any purpose other than to pay for labor, materials, services, equipment or machinery supplied to the improvement. Such a misapplication of loan proceeds is a Class E felony and the owner will be liable for any damages and expenses that are the result of the misapplication.
- If any amounts remain unpaid to remote contractors or if a contractor has been served with a Notice of Nonpayment that remains unpaid, that contractor may not use the proceeds of any payment received other than to pay for labor, materials, services, equipment or machinery supplied to the improvement. Such a misapplication of payment proceeds is a Class E felony and the contractor will be liable for any damages and expenses that are the result of the misapplication.
- If a lienor willfully and grossly exaggerates the amount of a lien, it may be liable for resulting expenses incurred by the injured party.

Liens against Lessees or Multi-Unit Developments

- A prime contractor or remote contractor of a lessee of real property may not acquire a lien on the owner's interest in the property unless the lessee is deemed to be the owner's agent. Whether or not the lessee is the owner's agent will be determined by the following: the extent of the owner's control of the conduct of the lessee with respect to the improvement; whether the lease requires the specific improvement; whether the cost of the improvement is actually borne by the owner through offsets in rent; whether the

owner maintains control over the improvement; and whether the improvement becomes the property of the owner at the end of the lease.

- Contracts for improvements on contiguous or adjacent lots require only one claim of lien if the improvements are operated as a single improvement. If the improvements are to be operated separately, a separate Notice of Lien for each lot, parcel or tract of land is required. The separate liens must be in the amount of the improvements on the corresponding lot, parcel or tract of land.
- If an improvement to a common interest community was contracted for by the association of unit owners, the lien attaches to all units in the common interest. If the improvement was contracted for by a single unit owner, the lien attaches only to that owner's unit.

CONTRACTOR LICENSES

The General Assembly also changed contractor licensing requirements. Home improvement contractors are now licensed and regulated through the Board for Licensing Contractors, rather than the Home Improvement Commission. The licensing fee for home improvement contractors has been increased to \$250 for two years.

Additionally, when general contractors and home improvement contractors submit an application for licensure or renewal, they also must submit affidavits affirming that they maintain general liability insurance and workers' compensation insurance. The Board for Licensing Contractors has established the minimum allowable general liability insurance amounts as follows:

Contractor's License Monetary Limit	Minimum General Liability Insurance
Up to \$500,000	\$100,000
\$500,001 to \$1,500,000	\$500,000
\$1,500,001 to Unlimited	\$1,000,000

Finally, the Board for Licensing Contractors may specify emergency actions that can be taken by the executive director without a meeting of the board. These actions are limited to increases in license monetary limits and consideration of licensure applications and renewals. The actions taken by the Executive Director for the Board must be posted on the Board's Web site and reviewed at the next scheduled board meeting.

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