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BILL ANALYSIS

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Senate Bill 405 (Substitute S-4 as passed by the Senate)
Senate Bill 459 (Substitute S-5 as passed by the Senate)
Sponsor: Senator Valde Garcia (S.B. 405)
Senator Raymond E. Basham (S.B. 459)
Committee: Economic Development, Small Business and Regulatory Reform

Date Completed: 11-21-06

RATIONALE

The Construction Lien Act was enacted in 1980 to provide for the creation and enforcement of liens on real property, in order to protect the rights of people who perform labor or supply material or equipment for the improvement of the property. Under the Act, a contractor, subcontractor, supplier, or laborer has a construction lien on the interest of the owner or lessee who contracted for the property improvement. The Act also is designed to protect homeowners from having to pay twice for labor or materials or potentially losing their home. The Homeowner Construction Lien Recovery Fund, created under the Act, is used to pay claims of subcontractors, suppliers, and laborers, if the owner or lessee of residential property can demonstrate that he or she paid for the contracted services. The Fund is supported by assessments against licensed contractors, a fee charged to laborers who recover from the Fund, and a fee charged to other lien claimants who choose to become members of the Fund. As it did in 2004, the Department of Labor and Economic Growth may impose an additional assessment if the balance of the Fund is below \$1.0 million. Evidently, claims against the Fund have risen in recent years, and payments have been more than anticipated—due, in part, to interest that is added to amounts owed by contractors. To ensure that the Fund remains solvent, it has been suggested that the funding mechanism should be revised and other measures should be taken.

CONTENT

Senate Bill 405 (S-4) would amend the Construction Lien Act to do the following:

- **Limit interest payable from the Homeowner Construction Lien Recovery Fund to interest that accrued within 90 days after a claim of lien was filed.**
- **Require a supplier to show that he or she had obtained a credit report from a contractor and, if applicable, a personal guaranty, in order to recover from the Fund.**
- **Limit payment to a supplier who did not require advance payment from a contractor who was already indebted to the supplier.**
- **Increase the maximum Fund payment to subcontractors, suppliers, and laborers from \$75,000 to \$100,000 per residential structure.**
- **Require the Department of Labor and Economic Growth (DLEG) to maintain a website and post the name of contractors that failed to pay subcontractors or suppliers, resulting in payment from the Fund.**
- **Require an owner or lessee to notify each subcontractor, supplier, and laborer named in a sworn statement (which a contractor must give to the owner or lessee when requesting payment) that the statement had been received.**
- **Provide that an owner, lessee, or designee could not accept a full or partial waiver of lien from a person**

other than the lien claimant named in the waiver, without verifying its authenticity.

Senate Bill 459 (S-5) would amend the Construction Lien Act to:

- Require licensed contractors to pay a \$10 fee upon initial licensure and a \$10 fee for each year of license renewal, rather than a \$50 fee upon initial licensure, for deposit in the Homeowner Construction Lien Recovery Fund.**
- Require laborers and other lien claimants to pay a \$30 fee every three years.**
- Delete the authority of the DLEG Director to require additional assessments when the Fund balance is under \$1.0 million.**
- Suspend renewal fees if the Fund balance exceeded \$6.0 million, until it was under \$4.0 million.**
- Limit the interest included in a construction lien of a subcontractor or supplier for a home improvement.**
- Allow a person to bring an action to discharge a lien that had been recorded by an unlicensed person, and provide that the unlicensed person would be liable to the plaintiff for damages.**

The bills are tie-barred to each other.

Senate Bill 405 (S-4)

Procedures for Recovery from the Fund

The Act provides that a claim of construction lien does not attach to a residential structure, to the extent payments have been made, if the owner or lessee files an affidavit with the court indicating that he or she has paid the contractor for the improvement and the amount of the payment, has not colluded with any person to obtain a payment from the Fund, and has cooperated with DLEG in the defense of the Fund. The bill would require the owner or lessee to attach to the affidavit copies of the contract, any change orders, and any evidence of the payment that he or she had, including a canceled check or a credit card or other receipt.

Currently, a person who has recorded a claim of lien and who is precluded from

having a construction lien under the previous provision, may recover from the Fund the amount for which the lien is established. Under the bill, the person could recover the amount he or she would have been entitled to recover but for the previous provision. The Act requires a person seeking recovery to establish various facts, including that he or she would be entitled to a construction lien on a residential structure except for the defense described above. The bill also would require the person to establish that the contractor or subcontractor with whom the person claiming the construction lien contracted was the same individual or legal entity with whom the owner or lessee contracted.

Recovery by a Supplier

Under the bill, if the person claiming a construction lien on a residential structure were a supplier, the person would have to establish that he or she had documentary proof that, unless the supplier had provided material or equipment to the contractor or subcontractor within the preceding year, before he or she provided the material or equipment that was the subject of the lien without obtaining advance payment in full, the supplier 1) required the contractor or subcontractor to whom he or she provided the material or equipment to complete and submit a credit application; and 2) before beginning to supply material or equipment to the contractor or subcontractor without obtaining advance payment in full, did either of the following, as applicable:

- If the contractor or subcontractor were a corporation whose shares were publicly traded, obtained a report on the contractor or subcontractor from a nationally recognized organization that provided credit ratings of businesses to determine the financial stability of the contractor or subcontractor.
- If the contractor or subcontractor were not a publicly traded corporation, both obtained a credit report on the owner or qualifying officer or the principal partners, officers, shareholders, or members of the contractor or subcontractor to determine the financial stability of the contractor or subcontractor; and obtained a personal guaranty from the owner or one or more of the partners, officers, directors, managing members, trustees, or

shareholders of the contractor or subcontractor.

Also, if a supplier were seeking to recover for material or equipment supplied to a contractor or subcontractor without obtaining advance payment in full, the supplier would have to establish that a credit report obtained by the supplier on the contractor or subcontractor did not disclose any of the following:

- That the contractor or subcontractor had become insolvent.
- That the contractor or subcontractor was subject to a receivership.
- An unsatisfied judgment.
- An outstanding tax lien.

A payment from the Fund to a supplier could not include money due for material or equipment supplied to a contractor or subcontractor without obtaining advance payment in full, if either of the following applied:

- The contractor or subcontractor was indebted to the supplier in an amount equal to or more than the credit limit established by the supplier for the contractor or subcontractor when the material or equipment was supplied.
- The contractor or subcontractor was more than 90 days delinquent in paying a debt to the supplier at the time the material or equipment was supplied.

For purposes of the second provision, it would be irrelevant that there was a delinquency of more than 90 days if the delinquency were 90 days or less when the material or equipment was supplied.

Payment from the Fund

The bill provides that a payment from the Fund could not include interest on the unpaid principal amount due, including a time-price differential or a finance charge, that accrued after 90 days after the claim of lien was recorded.

Currently, DLEG may not pay out of the Fund to subcontractors, suppliers, and laborers more than \$75,000 per residential structure. When it appears that the amount claimed from the Fund with respect to a residential structure will exceed that amount, DLEG may delay payment until the

total amount to be paid can be ascertained. If the total amount payable to subcontractors, suppliers, and laborers exceeds \$75,000, they must be paid their proportional shares of that amount. The bill would increase the \$75,000 cap to \$100,000.

Fund Expenditures

Under the Act, wages, professional fees, and other administrative expenditures necessary for the operation and defense of the Homeowner Construction Lien Recovery Fund may not exceed 20% of funds it collected in the previous fiscal year. If, however, a \$50 fee (described below) is not assessed against license applications and renewals during a year, the limitation on Fund expenditures must be calculated on the basis of the closest previous year in which the \$50 fee was assessed and collected.

The bill provides, instead, that except for legal counsel fees, the amount paid in a fiscal year for wages, professional fees, and other administrative expenditures could not exceed 20% of the average of the ending balances in the Fund for the previous two fiscal years.

Other Fund Provisions

Foreclosure. Under the Act, a subcontractor, supplier, or laborer who seeks enforcement of a construction lien on a residential structure through foreclosure must join the Fund as a defendant in the foreclosure action. Under the bill, the subcontractor, supplier, or laborer would have to do so within the period provided in Section 117(1) (i.e., not later than one year after the date the claim of lien was recorded).

DLEG Website. The bill would require DLEG to maintain a website. If the Department made a payment from the Fund as the result of a contractor's failure to pay a subcontractor or supplier, DLEG would have to post on the website the name and license number of the contractor and of any qualifying officer of the contractor. The website would have to be designed to allow a visitor to search the posted names and license numbers of contractors and qualifying officers.

Sworn Statement

The Act requires a contractor to provide a sworn statement to an owner or lessee when payment is due to the contractor from the owner or lessee or the contractor requests payment from the owner or lessee, and when a demand for a sworn statement has been made by or on behalf of the owner or lessee. A subcontractor also must provide a sworn statement to an owner or lessee on demand, and must provide a sworn statement to the contractor when payment is due to the subcontractor from the contractor or when the subcontractor requests payment. The sworn statement must be in substantially the form described in the Act.

Under the bill, upon receiving a sworn statement, the owner or lessee, or the owner's or lessee's designee, would have to give notice in writing, by telephone, or personally, to each subcontractor, supplier, and laborer named in the sworn statement of its receipt. If a subcontractor, supplier, or laborer named in the sworn statement made a request within 10 days after receiving the notice, the owner, lessee, or designee would have to give the requester a copy of the sworn statement. The sworn statement described in the Act would have to include language to this effect.

Currently, the sworn statement must include the name of each subcontractor, supplier, or laborer for whom payment of wages or fringe benefits and withholdings is due. The bill would require it to include the address and telephone number of these people, as well.

Waiver of Right to Construction Lien

The Act prohibits a person from requiring, as part of any contract for an improvement, that the right to a construction lien be waived in advance of work performed. A lien claimant who receives full payment for his or her contract must give the owner, lessee, or designee a full unconditional waiver of lien. A lien claimant who receives partial payment must give the owner, lessee, or designee a partial unconditional waiver of the lien for the amount that the claimant has received, if the owner, lessee, or designee requests the partial waiver.

Under the bill, an owner, lessee, or designee could not accept a full or partial unconditional or conditional waiver of lien from a person other than the lien claimant named in the waiver, unless the owner, lessee, or designee first contacted the named lien claimant to verify its authenticity. (This would be subject to current provisions under which an agent who is authorized to prepare, record, and serve a claim of lien on behalf of a laborer or group of laborers is automatically authorized to provide and responsible for providing waivers of lien, unless the laborer or group notifies the designee that someone other than the agent is authorized to provide appropriate waivers.)

Forms must be used in substantially the format contained in the Act to execute waivers of construction liens. The bill would designate the forms, "Partial Unconditional Waiver", "Partial Conditional Waiver", "Full Unconditional Waiver", and "Full Conditional Waiver". Each of the forms would have to contain the following statement: "If the owner or lessee of the property or the owner's or lessee's designee does not receive this waiver directly from me/one of us, the owner, lessee, or designee must contact me/one of us directly to verify that it is authentic."

Senate Bill 459 (S-5)

Interest

After the bill's effective date, a subcontractor's or supplier's construction lien for an improvement to a residential structure could include an amount for interest, including a time-price differential or a finance charge, only if the amount were in accordance with the terms of the contract between the subcontractor or supplier and the contractor or subcontractor, and did not include any interest that accrued after 90 days after the claim of lien was recorded.

Licensure Requirement; Discharge of Lien

Under the Act, a contractor does not have a right to a construction lien on the interest of an owner or lessee in a residential structure unless the contractor has provided an improvement to the residential structure pursuant to a written contract between the owner or lessee and the contractor. The contract must state that a residential builder

or residential maintenance and alteration contractor, an electrician, and a plumbing contractor are required to be licensed under the applicable statutes. If the contractor is required to be licensed to provide the contracted improvement, the contract must state that the contractor is licensed and state the license number. The bill also would require the contract to state that a mechanical contractor is required to be licensed under the Forbes Mechanical Contractors Act.

Under the bill, the owner of residential property on which a construction lien had been recorded by a person who was not licensed as required by the Act, or any person affected by the lien, could bring an action to discharge the lien. If the court determined that the person who recorded the lien was not licensed as required, that person would be liable to the person who brought the action for all damages that resulted from the recording and any attempts to enforce the lien, including actual costs and attorney fees.

A person who brought an action to recover for the performance of an act or contract for which a license was required would have to allege in the complaint and would have the burden of proving that he or she was properly licensed.

Fees

Licensed Contractors. The Act imposes a \$50 fee on individuals applying for initial licensure as a residential builder or residential maintenance and alteration contractor, electrical contractor, plumbing contractor, or mechanical contractor. The fee must be paid in addition to the license fee and is deposited in the Homeowner Construction Lien Recovery Fund.

The bill would delete the \$50 fee. Instead, a person would have to pay a \$10 fee when applying for one of the licenses described above. When applying to renew the license, the person would have to pay a \$10 fee for each year that the renewed license would be valid.

Laborers & Other Lien Claimants. Currently, a laborer who seeks to recover from the Fund is not required to pay a fee until he or she obtains a recovery; at that time, a \$15 fee must be withheld from the Fund from

the laborer's final recovery. Under the bill, this would apply the first time that a laborer sought to recover from the Fund. The bill would delete a provision under which the total amount withheld by the Fund from a laborer in a one-year period may not exceed \$50.

Under the Act, except for licensed contractors and laborers, any other lien claimant may become a member of the Fund by paying a \$50 fee before the date of the claimant's contract for the improvement to a residential structure. The bill would delete a provision that limits a lien claimant's fee to \$50 in a year. Under the bill, if a lien claimant were a supplier that conducted business from more than one retail location, each retail location would have to be treated as a separate person for purposes of paying fees and renewal fees for Fund membership.

Under the bill, if a laborer or other lien claimant paid an initial fee (described above) on or before June 1, 2006, he or she would have to pay a \$30 renewal fee by June 1, 2009, and a \$30 renewal fee by June 1 of every third year after the first renewal payment. If the person paid the initial fee after June 1, 2006, he or she would have to pay a \$30 renewal fee by the first June 1 following the third anniversary date of the initial payment, and a \$30 renewal fee by June 1 of every third year after the first renewal payment.

A laborer or other lien claimant could pay a renewal fee after the date it was due, but would not be entitled to recover from the Fund for an improvement made after the due date and before the fee was paid.

At least 30 days before a renewal payment was due, DLEG would have to send a notice of the amount that would be due and the payment due date to the laborer or other lien claimant who paid the fee to recover from or be a member of the Fund. The notice would have to be sent by ordinary mail to the last address that the person gave the Fund administrator.

Fund Balance. Under the Act, if the Fund balance is under \$1.0 million on December 1 of any year, the DLEG Director may require an additional assessment or payment, not to exceed \$50, from licensed contractors and other lien claimants, unless the Legislature adopts a concurrent resolution to prohibit

the additional assessment within 30 legislative days after the Director requires the assessment. The bill would delete this provision.

Under the bill, if the Fund balance were over \$6.0 million on December 1 of any year, a renewal fee with a due date after January 1 of the following year would not be due. If the Fund balance were under \$4.0 million on any subsequent December 1, renewal fees would be due after January 1 of the following year.

Notice of Change

Under the bill, a person who became a member of the Fund by paying a fee would have to give the DLEG division that administers the Fund written notice of a change in the person's name, address, or form of business organization within 30 days of the change. If required by law, written notice also would have to be given to the appropriate licensing agency. Proof that a notice or other document related to the Act was mailed, or delivered by another method of delivery required by law or rule, to a member at the last address that the member gave the Fund administrator, would be conclusive proof that the member received the notice or document.

MCL 570.1110 et al. (S.B. 405)
570.1104 et al. (S.B. 459)

BACKGROUND

After a decade of negotiations between contractors, suppliers, laborers, consumers, lenders, and attorneys, the Construction Lien Act was enacted in 1980 to replace the Mechanics' Lien Act of 1891, which was considered highly ambiguous and arcane. The new statute retained the principal goal of the original law: to ensure that everyone involved in providing improvements and construction services to property owners receives proper payment. The 1980 Act also is designed to ensure that property owners—particularly homeowners—do not lose their rights, or are not forced to undergo expensive and prolonged litigation because someone else failed to fulfill a contract. Because of the complexity of the statute, it was not scheduled to take effect until January 1, 1982, so technical flaws could be identified and remaining differences resolved. Several amendments were

enacted late in 1981, and the effective date of the balance of the Act was delayed until March 1, 1982. Legislation to address the remaining issues was enacted early in 1982.

The Construction Lien Act sets forth a series of procedures that require the parties involved in a construction project to file various notices, statements, and claims of lien, in order to create and enforce a lien. Some of the procedures differ if the property is considered residential, rather than commercial. The procedures that apply to residential property are described briefly below.

When an owner or lessee contracts for an improvement to a residential structure, he or she may be asked to provide a notice of commencement to the contractor. This document is a formal notice that work is beginning on the property, and informs the various parties of the name and address of the owner or lessee (or his or her designee). As the work progresses, subcontractors, suppliers, and laborers are required to give the owner or lessee a notice of furnishing. When asking the owner or lessee for payment, or upon that person's request, the contractor is required to provide a sworn statement, which is a notarized document showing every subcontractor, supplier, and laborer who provided labor and material to the project. When making a payment, the owner should receive partial or full waivers of lien, which are agreements by the subcontractors, suppliers, or laborers that they will not file claims of lien against the property because they have been paid the amount indicated in the waivers.

The right of a contractor, subcontractor, supplier, or laborer to a construction lien will cease to exist unless a claim of lien is recorded in the register of deeds office within 90 days after the lien claimant last furnished labor or material. The claim of lien must be served on the owner's or lessee's designee, or on the owner or lessee. Proceedings to enforce a construction lien and foreclose any interests subject to it must be brought in the circuit court within one year after the claim of lien was recorded. Every person who has an interest in the real property involved in the action that would be impaired by the foreclosure of the lien, must be made a party to the action. A subcontractor, supplier, or laborer who seeks to enforce a construction lien on a

residential structure through foreclosure must join the Homeowner Construction Lien Recovery Fund as a defendant.

A claim of lien does not attach to a residential structure if the owner or lessee files an affidavit with the court stating that he or she has paid the contractor for the improvement, not colluded with any person to obtain payment from the Fund, and cooperated and will continue to cooperate with DLEG in the defense of the Fund. A lien claimant seeking to recover from the Fund must establish that he or she otherwise would be entitled to a construction lien on the property; that the owner or lessee paid the contractor or subcontractor, who retained or used the proceeds without paying the lien claimant; that the lien claimant made a reasonable effort to obtain payment from the contractor or subcontractor; that the lien claimant complied with any applicable licensing acts; and that the contractor or subcontractor was licensed. The court must determine the amount due to the lien claimant.

If DLEG makes a payment from the Fund, the Department may maintain an action against the contractor or subcontractor who did not pay the lien claimant. The Department also must enter a complaint against the licensee with the appropriate licensing agency.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The Construction Lien Act took effect in 1982 and has not been amended since then (with the exception of revisions to criminal penalties for fraudulent sworn statements). The bills would update the Act and address structural deficiencies, particularly in regard to the Homeowner Construction Lien Recovery Fund. As of June 2005, there had been over 2,765 claims against the Fund from subcontractors, suppliers, and laborers, and the Fund had paid out \$6.4 million in judgments for justified claims. Although the Fund may file an action against a contractor for indemnification, less than 3% of the payouts had been recovered, according to DLEG, mainly because of contractors' going out of business or filing for bankruptcy.

Apparently, claims have climbed over the years and payouts have been greater than anticipated. The size of payments is due in large part to substantial amounts of interest on unpaid balances owed to suppliers, who are under no obligation to establish the creditworthiness of contractors. In practice, Fund payments are negotiated with lien claimants, but there presently is no limit in the Act and the Fund technically could be liable for the entire amount of interest owed (subject to the cap on total recovery per residential structure). Other factors contributing to the size of payouts include inflationary increases in the cost of material and labor, as well as the Fund's legal defense costs.

The bills would address these concerns in various ways. The revised assessment structure would create a stable, predictable source of revenue for the Fund. Rather than providing for one-time assessments and fees plus an additional assessment when the Fund balance drops below \$1.0 million, the bill would require the payment of ongoing assessments and renewal fees, and would allow the Fund balance to reach \$6.0 million before renewal fees were suspended. Reinstating renewal fees when the balance fell below \$4.0 million would maintain at least the current level in the Fund, which had a balance of \$3.4 million as of September 25, 2006.

The bills also would preserve the solvency of the Fund by reigning in payments for interest. Subcontractors, suppliers, and laborers could not recover interest that accrued more than 90 days after a claim of lien was recorded, and suppliers would have to obtain satisfactory credit reports on contractors (and a personal guaranty in some cases) if the suppliers did not receive advance payment in full. In addition, the bill would prevent payments to a supplier who provided material or equipment to a contractor that exceeded the credit limit set by the supplier or owed a debt to the supplier that was more than 90 days past due. These provisions would put the onus on suppliers to ensure that contractors were creditworthy, rather than relying on the Fund to recover unpaid balances plus large amounts of interest.

Supporting Argument

The bill would increase consumer protections in several ways. Under Senate Bill 405 (S-

4), DLEG would have to maintain a website of contractors whose failure to pay subcontractors or suppliers caused the Fund to make a payment. Homeowners then could search the site and avoid doing business with contractors who were unreliable. Senate Bill 459 (S-5) would allow a homeowner to bring an action to discharge a lien that was recorded by a person who was not licensed as required. If the homeowner prevailed, the unlicensed person would be liable for damages, including costs and attorney fees, that resulted from the recording and attempts to enforce the lien.

Supporting Argument

Subcontractors, suppliers, and laborers would have additional protections under Senate Bill 405 (S-4). The bill would require a property owner or lessee to notify those named in a contractor's sworn statement, upon receiving the statement. This would let subcontractors, suppliers, and laborers know that the contractor was requesting payment from the owner or lessee. The bill also would prohibit an owner or lessee from accepting a waiver of lien from anyone other than the lien claimant, without first verifying its authenticity.

In addition, the amount that may be recovered from the Fund per residential structure has been \$75,000 since it was established over two decades ago. Raising the cap to \$100,000 would reflect today's higher costs of material, equipment, and labor.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

Senate Bill 405 (S-4)

The bill would tend to reduce payments from the Homeowner Construction Lien Recovery Fund. Although the size of payments from the Fund would increase, contractors would be required to meet more stringent criteria in order to collect from the Fund. In addition, new limits would apply to interest payments on claims, further reducing expenditures from the Fund.

The bill would revise the limit on administrative expenses of the Fund. The limit would change from 20% of the ending balance in the previous fiscal year to 20% of the average of the ending balance in the previous two fiscal years. The averaging

would reduce the volatility of the limit on administrative expenses.

The bill would have no impact on the State's General Fund revenue or expenditures.

The bill would have no fiscal impact on local government.

Senate Bill 459 (S-5)

The bill would change the revenue stream for the Homeowner Construction Lien Recovery Fund, a restricted revenue fund with the Department of Labor and Economic Growth. Currently, the revenue to the Fund consists of fees and special assessments. Residential builders and contractors pay a \$50 fee to the Fund at the time of applying for their initial licenses. Special assessments may be levied at a rate of \$50 per licensed contractor. The special assessments are levied at the direction of the DLEG Director when the balance in the Fund falls below \$1.0 million as of December 1 of any year. The most recent special assessment was levied in FY 2004-05 and, if fully collected, will generate approximately \$4.7 million for the Fund.

Under the bill, the authority for special assessments and the initial license fees would be eliminated. Instead, a fee would be levied with the renewal of residential builder and contractor licenses. The fee would be \$10 for each year the license was in effect. Revenue from these fees is estimated at \$950,000 annually.

It is expected that administrative expenses would be reduced by the bill because collection of fees would be done in conjunction with regular license renewals, instead of requiring separate mailing and processing as with the special assessments.

The bill would have no impact on the State's General Fund revenue or expenditures.

The bill would have no fiscal impact on local government.

Fiscal Analyst: Elizabeth Pratt
Maria Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.