

Legislative Analysis



ABOLISH HOMEOWNER CONSTRUCTION LIEN RECOVERY FUND

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House Bill 5830 (Substitute H-1)
House Bill 5835 as introduced
Sponsor: Rep. Richard E. Hammel

House Bills 5831-5834 as introduced
Sponsor: Rep. Fred Durhal
Committee: Appropriations

Complete to 6-18-10

A SUMMARY OF HOUSE BILLS 5830-5835 AS PASSED BY THE HOUSE 6-16-10

House Bill 5830 would amend the Construction Lien Act to repeal provisions concerning the Homeowner Construction Lien Recovery Fund (HCLRF), which is essentially insolvent and cannot meet the demand for claims from the fund. House Bills 5831-5834 would amend various building trades licensing acts to delete requirements that contractors pay into the HCLRF. House Bill 5835 amends the Code of Criminal Procedure concerning the penalty for making false statements to receive payment from the HCLRF. House Bill 5830 is tie-barred to all of the other bills, which are, in turn, tie-barred to HB 5830.

House Bill 5830 - Construction Lien Act

The bill would amend the Construction Lien Act to repeal Sections 201 to 207, 303, and 304 of the act.

Section 201: Creates fund, noting that it shall be "self-supporting" and funded from a \$10 fee due upon initial licensure and a \$10/year renewal fee when a license is renewed. The fee is imposed on residential builders and maintenance and alteration contractors, electrical contractors, plumbing contractors, mechanical contractors. Laborers seeking to recover from the fund must pay a \$15 fee, and other lien claimants must pay a \$50 fee, with an additional \$30 renewal fee.

Section 202: Charges the Department of Energy, Labor, and Economic Growth with the financial management of the fund. All wages and other administrative costs, including legal fees are to be payable from the fund, subject to certain limitations.

Section 203: Provides that a claim of construction lien does not attach to a residential structure, to the extent payments have been made, if the owner files an affidavit that he/she has, among other things, paid the contractor according to the contract and cooperated, and will cooperate, with the department in defending the fund. The section also provides that a person who is precluded from having a construction lien may recover from the HCLRF the amount to which he or she would have been entitled.

Section 204: Limits the amount payable from the HCLRF to subcontractors, suppliers, and laborers to not more than \$100,000 per residential structure. If the total amount exceeds \$100,000, the amount payable is prorated.

Section 205: Provides that the state and officers are not personally liable to any subcontractor, supplier, or laborer for payment, except from the fund. If the department makes a payment from the fund, it may maintain an action against the contractor or subcontractor who did not pay the claimant receiving payment from the fund. Any amount recovered by the department is credited to the HCLRF.

Section 206: Requires DELEG to maintain a website on the HCLRF, and requires it to post the name of contractors that fail to make their required payments. The names of licensees are forwarded to the licensing agency for appropriate disciplinary action.

Section 207: Provides that submitting false information to the department in order to receive payment from the fund is a felony.

Section 303: Repealed 1891 PA 179 (Mechanic's Lien Law) and 1893 PA 172 (Discharge of Liens on Real Estate).

Section 304: Created a joint legislative review committee to review the status of the fund, and submit a report no later than February 1, 1985.

The substitute adds a new section that provides that a claim of 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 stating that the owner or lessee has paid the contractor according to the contract and stating the amount paid. The owner or lessee would also have to include copies of the contract and any change orders, and evidence that payment has indeed been made, such as a canceled check, credit card receipt, or other receipt. (This section mimics existing language in Section 203 that would be repealed under the bill.)

House Bill 5831 - Electrical Administrative Act

The bill would amend the Electrical Administrative Act to repeal two provisions concerning the HCLRF. The first provision requires the payment of the HCLRF membership fee by electrical contractors, as prescribed in the Construction Lien Act. The second provides that if an electrical contractor fails to pay a lien claimant who received payment from the HCLRF, the licensee's license is suspended (and not to be renewed) until full restitution is made to the fund (including interest and litigation costs).

House Bill 5832 - Forbes Mechanical Contractors Act

The bill would amend the Forbes Mechanical Contractors Act to repeal provisions concerning the HCLRF. The first provision requires the payment of the HCLRF membership fee by mechanical contractors, as prescribed in the Construction Lien Act. The second provides that if a mechanical contractor fails to pay a lien claimant who received payment from the HCLRF, the licensee's license is suspended (and not to be renewed) until full restitution is made to the fund (including interest and litigation costs).

House Bill 5833 - State Plumbing Act

The bill would amend the State Plumbing Act to repeal provisions concerning the HCLRF. The first provision requires the payment of the HCLRF membership fee by plumbing contractors, as prescribed in the Construction Lien Act. The second provides that if a plumbing contractor fails to pay a lien claimant who received payment from the HCLRF, the licensee's license is suspended (and not to be renewed) until full restitution is made to the fund (including interest and litigation costs).

House Bill 5834 - Occupational Code

The bill would amend Article 24 (Residential Builders and Maintenance and Alteration Contractors) of the Occupational Code to repeal provisions concerning the HCLRF. The first provision requires the payment of the HCLRF membership fee by builders and M&A contractors, as prescribed in the Construction Lien Act. The second provides that if a licensee fails to pay a lien claimant who received payment from the HCLRF, the licensee's license is suspended (and not to be renewed) until full restitution is made to the fund (including interest and litigation costs).

House Bill 5835 - Code of Criminal Procedure

The bill would amend Chapter XVII (Sentencing Guidelines) of the Code of Criminal Procedure to repeal a provision that provides that providing false information to obtain payment from the HCLRF is a Class G crime against property, the maximum penalty for which is a prison sentence of 4 years.

BACKGROUND INFORMATION:

Construction Liens

A construction lien (or a mechanic's lien) is a lien against real estate given by statute to a person who improves the real estate against which the claim of lien is asserted but who has not been paid for such work as provided in the construction contract. As a security interest on that real estate, a construction lien serves to facilitate the satisfaction of the debt (uncompensated work). Mechanic's lien laws have always been a part of the state's history, with the first such law adopted in 1827, prior to statehood. For many years, the Mechanic's Lien Act of 1891 governed the construction lien process in the state. However, over the years, through numerous legislative amendments and as the result of persistent litigation, the MLA had become "unnecessarily complex"¹. For the lien claimant, the process of recording and enforcing a construction lien had become "a veritable obstacle course strewn with pitfalls, uncertain of achievement, subject to interminable delays, expensive litigation and haphazard results when it is contested, as it usually is, by the owner, the mortgagee or another lien claimant."²

¹ *Outline of Mechanic's Lien Law in Michigan*, Real Property Law Section Newsletter, State Bar of Michigan, August 1976, [<http://www.dleg.state.mi.us/bcsc/forms/conlien/llf-600.pdf>].

² *11th Annual Report, 1976*, Michigan Law Revision Commission.

As a result, the Construction Lien Act (CLA), 1980 PA 497, was enacted to substantially revise and improve upon the Mechanic's Lien Act.³ The CLA continues to provide for the protection of lien claimants to secure payment for wages and materials. The CLA establishes the process by which contractors, subcontractors, suppliers, and laborers may perfect and record a lien in order to secure payment for unpaid work, supplies, and equipment on home building or remodeling project. On this point, DELEG notes, "[w]ork, supplies, or equipment needed for the project are purchased by the contractor that the homeowner has hired to do the work. However, if that contractor does not pay for the work or materials provided, the subcontractors, suppliers, and laborers have no recourse but to try to get the homeowner to pay them...To get a homeowner to pay, the law allows them to place a 'construction lien' on the property. This legal device clouds the title to the property just as unpaid taxes do. This unpaid claimant may go to court to 'foreclose' on the lien and force the property owner to sell the home to pay the debts if they could not otherwise pay."⁴

However, the CLA also sought to protect homeowners against the possibility of having to pay twice for home improvements to avoid the attachment of a lien against their property. This was accomplished through the creation of the Homeowner Construction Lien Recovery Fund. As the department notes, "[i]n the past, if a homeowner had completely paid the contractor for the work done, but the subcontractors, suppliers, or laborers were not paid for materials or labor they had furnished, the loss was often borne by the homeowner who had to pay twice to protect his or her property from a lien. Now, under the Construction Lien Act, unpaid contractors, suppliers, and laborers may present their claims to the [HCLRF]."⁵

To facilitate the free flow of information concerning the construction project and who is working on it, the act requires several written notifications. A *Notice of Commencement*, recorded with the county register of deeds, provides formal notice that work is beginning on a property and notifies parties involved in the project of the name and address of the owner so that legal notices and bills can be sent. A *Notice of Furnishing* is provided by each person providing labor or materials, and places the owner on notice as to the subcontractors and suppliers involved in a project and the owner's obligation to ensure the subcontractor or supplier is paid. (This makes the owner aware of potential lien claimants.) When demanding payment, the contractor provides a *Sworn Statement* indicating every subcontractor, supplier, and laborer involved in a project. The statement is checked against the notices of furnishing, and is a key document in protecting against a construction lien. A *Waiver of Lien* is a written instrument signed by a contractor, subcontractor, supplier, or laborer to relinquish (wholly or in part) a claim of lien because they have already been paid, or they have an agreement on how they will be paid. The waiver may be complete and unconditional if the contractor, subcontractor, supplier, or laborer has been paid.

³ For an overview of the Construction Lien Act, see Lawrence Dudek and Marilyn K. Smyth, *Construction Liens: How Lien Law in Michigan Affects Commercial and Residential Property*, Michigan Bar Journal, December 2003, [<http://www.michbar.org/journal/pdf/pdf4article647.pdf>]. See, also, *Consumer's Guide to the Michigan Construction Lien Act & the Homeowner Construction Lien Recovery Fund*, Michigan Department of Energy, Labor, and Economic Growth, January 2009, [<http://www.dleg.state.mi.us/bcsc/forms/conlien/llf-600.pdf>].

⁴ *Consumer's Guide to the Michigan Construction Lien Act & the Homeowner Construction Lien Recovery Fund*

⁵ Ibid. The construction lien act applies to commercial and residential property, although the protections afforded by the HCLRF are only available for "residential structures" which include residential condominium units or residential buildings containing not more than 2 residential units, the land on which it is (or will be) located, and all appurtenances, in which the owner is residing (or will reside). The HCLRF does not apply to construction of apartment buildings, "spec" homes, or other commercial property.

In general, to perfect a lien, a *Claim of Lien* must be recorded with the county register of deeds within 90 days after furnishing labor or materials. The claim must be delivered within 15 days after it is received. To enforce the lien, a lien claimant must sue to foreclose the lien within one year. The foreclosure action will determine whether the claim is valid, and who should pay the claim. If an action is not brought within the time prescribed, the claim of lien is discharged.

Section 203 of the CLA provides that a claim of 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 the owner or lessee (1) paid the contractor for the improvement according to the contract, (2) had not colluded with another person to obtain payment from the HCLRF, and (3) had cooperated and will cooperate with DELEG in defending the fund.

Homeowner Construction Lien Recovery Fund

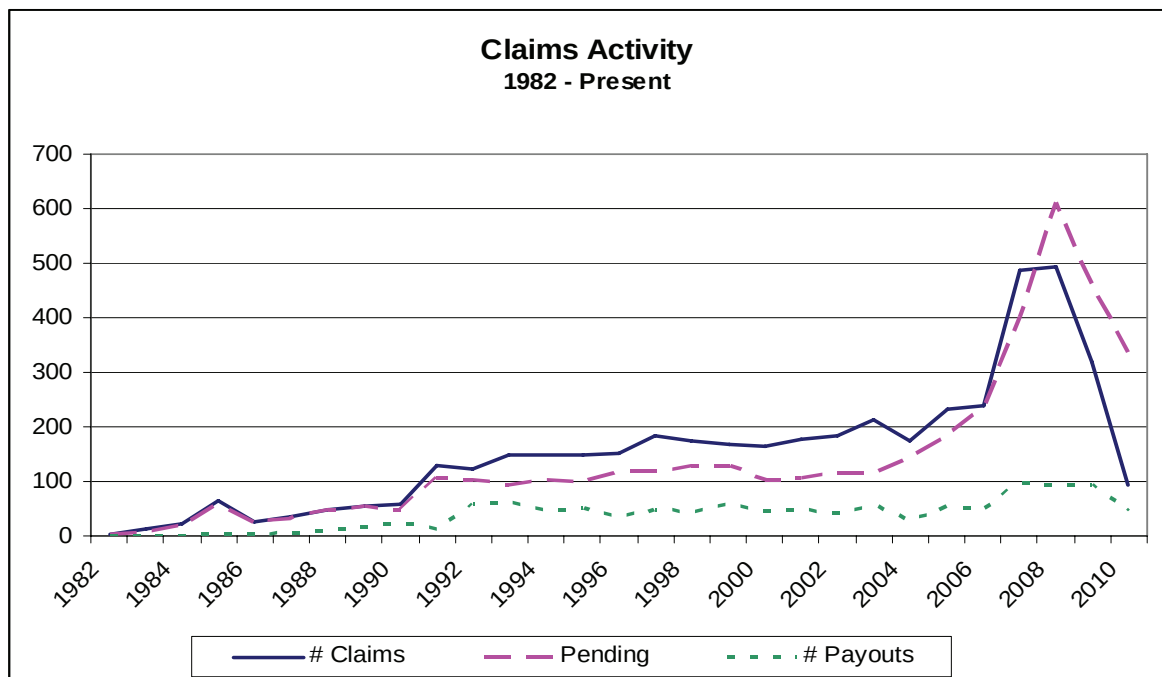
Under the CLA, all licensed contractors pay a "membership fee" of \$10 upon initial licensure and a \$10/year for when their license is renewed. (Renewals are generally on a 2-year or 3-year cycle). This fee applies to residential builders and M&A contractors, electrical contractors, plumbing contractors, and mechanical contractors. (Prior to amendments in 2006, the CLA imposed a one-time fee of \$50 at the time a license was initially issued.) Laborers may become members from the fund (and thus be eligible to seek payment from the HCLRF) upon payment of an initial fee of \$15 and a triennial renewal fee of \$30. Other lien claimants (e.g. suppliers) may become members from the fund upon payment of \$50 prior to the contract for improving a residential structure. Suppliers with multiple retail locations pay the \$50 fee for each location. There is also a triennial renewal fee of \$30 for other lien claimants. Prior to 2006 PA 497 (SB 405), the CLA imposed a \$50 special assessment on fund members (except laborers) when the HCLRF fund balance fell below \$1.0 million. These special assessments were imposed in 1999 and 2005.

Section 203 of the CLA provides that a person who recorded a lien claim and is precluded from obtaining a construction lien (because of payment by the owner or lessee) may seek recovery from the fund in the amount for which they are entitled by establishing, among other things, that (1) he or she would be entitled for a construction lien, (2) that payment was made by the owner or lessee to the contractor or subcontractor, (3) that the contractor or subcontractor has used any part of the proceeds received without having paid the lien claimant, (4) he or she has not colluded with others to receive payment from the HCLRF, (5) he or she has complied with applicable licensing act, and (6) that the contractor or subcontractor with whom the lien claimant contracted is licensed if required to be.

The HCLRF is defended by the Attorney General which "shall make every reasonable effort to defend the fund and may assert any defense to a claim of lien that would have been available to the owner or lessee." Payments are made from the fund only after the court finds that a subcontractor, supplier, or laborer is entitled to payment. The amount of the payment is limited to \$100,000 per residential structure. If the amount claimed exceeds \$100,000, the amount paid is prorated among the lien claimants. The CLA further provides that if a payment is made from the HCLRF, then DELEG may maintain an action to against the contractor or subcontractor that did not pay the claimant receiving payment from the fund.

FISCAL IMPACT:

The Department of Energy, Labor, and Economic Growth notes that the Homeowner Construction Lien Recovery Fund (HCLRF) had an unobligated balance as of June 17, 2010, of negative \$68,231.67.⁶ Clearly, there are not sufficient resources to pay the claims pending against the fund.⁷ The department notes that the number of claims (and the total dollar amount of such claims) has increased substantially from 2006 to 2008 and has remained higher than historical averages, as shown in the chart below.



Source: Department of Energy, Labor, and Economic Growth

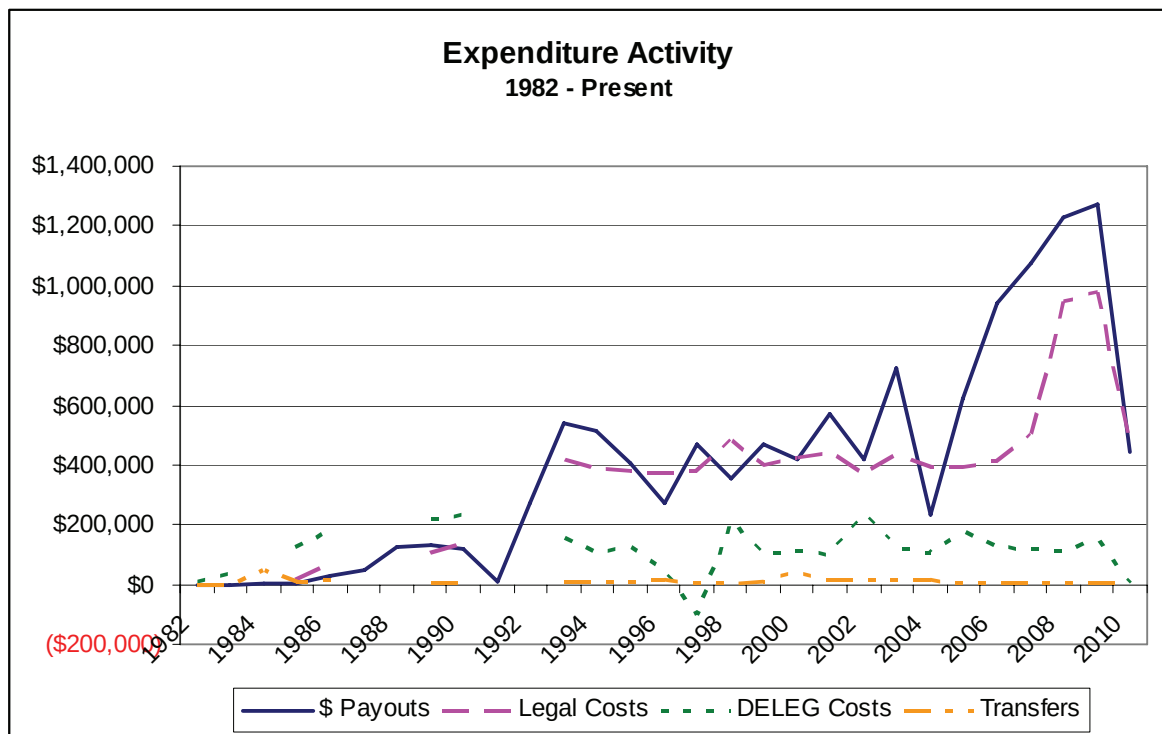
⁶ According to the DELEG, the fund has a balance of \$16,058.33, with outstanding payments of \$5,775.00 and unpaid obligations totaling \$78,515.00. The most recent audit by the Office of the Auditor General was released in October 2008, reviewing the 2006 and 2007 fiscal years. The audit report noted no material findings concerning DELEG's administration of the fund. It did note an issue - a lack of detailed billings - related to invoices from the Department of Attorney General for legal services provided to the HCLRF. In noting that from September 30, 2007, to October 1, 2008, the HCLRF fund balance fell by 30.7%, the audit report said, "[t]he Fund's decrease in revenue resulted primarily from a decrease in license applications and a reduction in licensee fees. DLEG informed us that significant changes to the Builders' Licensing Law and the new requirement of a 60-hour pre-licensing course resulted in a decrease in the number of license applications. Also, DLEG stated that amendments to the Construction Lien Act reduced initial license fees from \$50 to \$10. The Fund's increase in expenditures resulted primarily from increases in new claims, increased total value of new claims, and increased legal expenses....According to DLEG, the Fund's decreased fund balance will negatively impact the Fund's continued ability to pay future claims." The audit report is available on the OAG's website, [<http://www.audgen.michigan.gov/comprpt/docs/r641042008.pdf>].

⁷ A notice on the DELEG Construction Lien Website - <http://www.michigan.gov/conlien> - notes, "[a]t the present time, the Fund has become essentially insolvent, with a declining balance and an ineffective funding source to cover pending claims...As long as the statutory provisions of the Fund are in place, the Fund is statutorily required to continue to collect the Fund revenue through the licensure process in addition to restitution payments to the Fund. This anticipated revenue is simply not enough to sustain the viability of the Fund." Mechanical contractors licenses that expire on August 31, 2010, are currently in the process of being renewed. The renewal fee will include the \$10/year HCLRF fee, until these bills are enacted.

In 2006, there were 240 new claims filed with the department. The number of new claims increased to 486 in 2007, 495 in 2008, and 320 in 2009. Payouts from the fund increased from about 50/year up to 2006 to nearly 100/year between 2007 and 2009. Currently, there are about 336 claims against the HCLRF pending. These claims total approximately \$25.1 million. Historically, the HCLRF has paid about 11.68% of the total value of claims made against the fund, meaning that the approximate liability of the fund for those 336 claims that are currently pending is \$2.9 million, if history proves to be any guide. However, the actual liability depends on the final disposition of a claim (judgment, dismissal, or settlement). Moreover, the continued receipt of claims in the future – were the fund not abolished – would add to its potential liability.

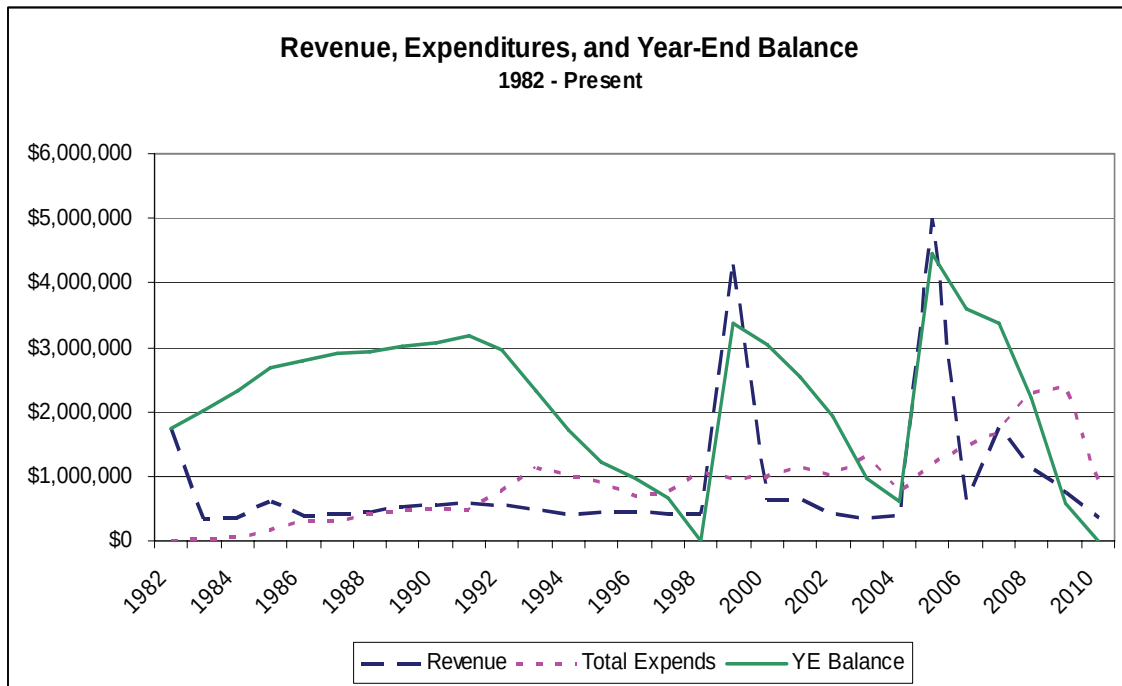
Since the establishment of the fund in 1982, it has received nearly 4,500 claims, valued at \$100.2 million. It has paid 1,151 claims totaling \$11.7 million. (A portion, as noted above, is still pending, while other claims were dismissed.) The lion's share of HCLRF activities (claims and payments) are related to suppliers.

The increased number of claims filed against the HCLRF has resulted in a concomitant increase in legal costs necessary to defend the fund and to recover payments made from the fund. Legal costs averaged around \$400,000 between FY 1993 and FY 2005. Those increased to nearly \$500,000 in FY 2006 and totaled nearly \$1.0 million in both FY 2007 and in FY 2008. DELEG's administrative costs and other costs (e.g. the civil service 1% charge), also supported by the HCLRF, have remained fairly stable over the years, totaling just over \$100,000 annually.



Source: Department of Energy, Labor, and Economic Growth

Over the years, revenue to the HCLRF has generally ranged from \$300,000-\$600,000 annually (except in 1999 and 2005 when the special assessment was imposed). Revenue increased to over \$1.0 million in FY 2007 and in FY 2008, with the increase attributable to the new fee structure and the timing of the license renewal cycle. From 1993 to FY 2005, total expenditures from the fund have been around \$1.0 million, ranging between \$700,000 and \$1.2 million. Expenditures grew to \$1.5 million in FY 2006, to \$2.4 million in FY 2009.



Source: Department of Energy, Labor, and Economic Growth

Once the HCLRF is abolished, claimants against the fund would have to pursue other legal remedies to receive payment for the uncompensated work. These remedies include pursuing a breach of contract claim against a contractor or pursuing an action for violation of the Michigan Building Trust Fund Act.⁸

Fiscal Analyst: Mark Wolf

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

⁸ The MBTFA (also known as the Building Contract Fund Act), 1931 PA 259, was enacted to prevent contractors from absconding with funds payable to others (suppliers, subcontractors, and laborers). Under the act, a contractor has a duty to use the proceeds from a building contract to first pay the amounts payable to suppliers, subcontractors, and laborers before using the proceeds for other purposes. For an overview of the Michigan Building Trust Fund Act see, David Morley, *The Michigan Builders Trust Fund Act: An Overlooked Remedy?*, Michigan Real Property Review, Vol. 21, No. 1 (Spring 1994), [<http://www.michbar.org/realproperty/MRPR/Vol.21No.1Spring1994.pdf>]. See, also, Paul J. Mastrangel, *The History and Application of the Michigan Building Contract Fund Act*, Michigan Real Property Review, Vol. 33, No. 1 (Spring 2006), [<http://www.michbar.org/realproperty/MRPR/spring2006.pdf>].