



LIEN INTO YOUR RIGHTS

How the revised Texas Mechanic's Lien Statute potentially alters an oil patch contractor's rights in a bankruptcy case.

WRITTEN BY DUSTON McFAUL AND MICHAEL FISHEL

The new year in Texas saw notable revisions to Chapter 53 of the Texas Property Code, otherwise known as the Texas Mechanic's Lien Statute. These changes took effect January 1, 2022, through the enactment of House Bill 2237. Construction vendors, especially those in the oil patch, should take note as these changes may affect their rights when dealing with a financially distressed counterparty that may file for bankruptcy. Because a mechanic's lien secures the obligation owed to the vendor with a lien in the improvements and to each lot of land necessarily connected, ensuring your mechanic's lien is timely filed and properly perfected should be in the forefront of all contractors' or subcontractors' minds. Moreover, oil patch trade vendors often rely on their mechanic's liens to assert a secured claim in a bankruptcy case on account of any unpaid invoice.

Certain trade claimants in Chapter 11 bankruptcy are often afforded priority over other claimants as a result of a bankruptcy court's approval of "First Day" motions, specifically a "Lienholders" or "Critical Vendor" motion. In requesting authority to prioritize payments to these trade vendors ahead of other creditors, a debtor may argue that certain vendors may stop providing goods or services post-bankruptcy unless their prepetition claims are paid. Debtors will also highlight to the court that these trade claimants have properly perfected a mechanic's lien securing the unpaid amount. As a result, debtors may present to the bankruptcy court that paying a prepetition claim to a trade vendor with a perfected mechanic's lien does not increase the trade claimant's recovery. Rather it only accelerates the timing of payment to the claimant.

Of course, this generally assumes that the underlying mechanic's lien is valid. The revisions to the Texas mechanic's statute, however, may put some of these mechanics' liens in question. For example, under the new law, claimants are now required

to file a lawsuit for lien foreclosure within one year from the last date the claimant was permitted to file its lien affidavit under § 53.052. Previously, the deadline to file a lawsuit was two years. As a result, the legal basis for payment on account of certain mechanic lienholder's claims may be undermined because if the claimant had not initiated a lawsuit within one year, the claimant would relinquish foreclosure rights, which in turn would undermine secured priority status within the bankruptcy case. As a result, mechanic lienholders should be mindful that stale lien claims, especially if significant, could be successfully challenged.

Although the shortening of the deadline change to the new law may hamper the rights of certain lienholders in bankruptcy, other changes to the Texas law will help creditors with expanded rights in a counterparty's bankruptcy. For example, under the new law, engineers and surveyors are no longer required to have a contract directly with the owner of the project to assert a valid mechanic's lien. Instead, a contract with a "purported original contractor"—a new term under the revised law—would be sufficient. Further, the new law broadens the definition of "improvement" to include additional aspects of a construction project, including surveys, designs, plans, drawings, plats, and specifications created in connection with a project. It grants lien rights to persons who perform such work regardless of whether the person has a direct contract with the owner. Previously, architects, engineers, and surveyors could assert a lien for work performed on a project only if the work was performed pursuant to a written contract with the owner. The revised law eliminates the requirement that such persons must contract directly with the owner in order to have a lien.

While these examples illustrate changes that may impact trade vendors in bankruptcy proceedings, numerous other changes were made to the Mechanic's Lien Statute—the first substantive amendment since 2011—that would allow general contractors and subcontractors to more easily comply with the law. Notably, HB 2237 received bipartisan support from both parties in the Texas Legislature as the bill passed 30-0 in the Senate and 141-1 in the House (with two abstaining). However, whether these changes ultimately benefit trade creditors asserting claims in a bankruptcy proceeding remains to be seen. **TBJ**



DUSTON McFAUL

is a restructuring partner in Sidley Austin, based in its Texas offices.



MICHAEL FISHEL

is counsel to Sidley Austin, where his practice focuses on both debtor and creditor representations. Additionally, he has extensive experience in representing energy clients in out-of-court transactions, including refinancings, 363 sales, and avoidance actions. Fishel was a history major at Columbia University and obtained his law degree from the University of Texas School of Law.