Approved: August 3, 2005
Date

MINUTES OF THE SENATE JUDICIARY COMMITTEE

The meeting was called to order by Chairman John Vratil at 9:30 A.M. on February 10, 2005, in Room 123-S of the Capitol.

All members were present except:
Derek Schmidt- excused

Committee staff present:
Mike Heim, Kansas Legislative Research Department
Jill Wolters, Office of Revisor of Statutes
Helen Pedigo, Office of Revisor of Statutes
Nancy Lister, Committee Secretary

Conferees appearing before the committee:
Edward P. Cross, Executive Vice President, Kansas Independent Oil and Gas Association
Stanley Jackson, Senior Vice President, Insurance Planning, Inc.
Kathy Olsen, Kansas Bankers Association
Matthew Goddard, Vice President, Heartland Community Bankers Association
William Larson, General Counsel to Associated General Contractors of Kansas
Woody Moses, Managing Director of the Kansas Ready Mixed Concrete Association

Others attending:
See attached list.

Chairman Vratil opened the meeting. There were no bill introductions.

Chairman Vratil opened the hearing on **SB 97**.

SB 97--Bill by Financial Institutions and Insurance Construction contracts; indemnification agreements

Proponents:
Ed Cross testified on behalf of the Kansas Independent Oil and Gas Association in support of the bill. The bill amends K.S.A. 2004 Supp. 16-121 to include oil and gas exploration and production activities in the definition of a construction contract. Mr. Cross stated that the bill augments last year's **HB 2154** which addressed indemnification provisions for construction contracts along with other railroad issues. The bill would disallow any hold harmless or indemnification agreement that called for a contractor to protect the operator if a claim of negligence were made against the operator. Mr. Cross stated the Association's goal is to make the Master Service Agreement what it started out being, and to eliminate what is above and beyond what the basic agreement did. (Attachment 1)

Stanley Jackson, testified on behalf of Insurance Planning, Inc., and stated that the one asked to assume the risk has the insurance and if there is a loss, then the premium goes up. (Attachment 2)

Chairman Vratil stated that the bill is basically HB2154 that the Governor signed into law last year, with the oil and gas industry added to it. They are asking for the same treatment as the railroad industry received in the House bill. Additionally, the Small Truckers Association is asking for the same treatment. Chairman Vratil stated he intends to ask for an interim study on whether the public policy of Kansas should permit one party to indemnify another party for that other party's negligence.

Chairman Vratil closed the hearing on **SB 97** and opened the hearing on **SB 112**.

SB 112--Materialman's liens; priority of claims; property under construction

Proponents:
Kathleen Taylor Olsen, representing the Kansas Bankers Association, stated she brought a guest, Dennis Hadley of the Dennison State Bank in Holton, in case there were questions. The bill amends several statutes relating to the priority of materialman's liens. K.S.A. 60-1101 establishes the basis for determining priority of claims against property under construction. The requested change in lines 30-32, page 1, states that

materialmans' liens are measured from the date that the earliest unpaid lien holder begins work on a property, and not the date work began by a party who has been paid in full. The second change also establishes the priority date for all other lien holders. Ms. Olsen stated that a recent court case, *Mutual Savings Association vs. Res/Com Properties,* cast doubt on the reliability of K.S.A. 60-1101. The court decision indicated that the priority date for all subsequent lien holders under the law could be established by a contractor or subcontractor who has been paid in full and no longer has a claim on the property, and that work that is not visible can establish the priority date for all other subsequent lien holders under the law. (Attachment 3)

Ms. Olsen stated that the intention of the bill is to ensure that improvements to a property are visible. A contractor should not be able to stick a sign in the ground, perform no work, and yet, because of the sign, be considered as having established visible work on the premise.

Chairman Vratil questioned whether an alternative should be to allow anyone that provides labor, equipment or supplies to a job site to file a simple one-page notice of lien with the Register of Deeds. That would then be considered public notice to the world, including any lender, that the lender may have reason to be concerned about a potential lien on the property. Ms. Olsen said that is what happens in Nebraska, and might solve the problem.

Senator Bruce cited K.S.A.60-1103 (A) which reads " Any supplier, sub-contractor or any other person furnishing labor, equipment, materials or supplies, used or consumed at the sight of the property subject to lien, under agreement with the contractor, or sub-contractor or owner contractor may obtain a lien for the amount due in the same manner and to the same extent as the original contractor." He questioned if there still would be some conflict, because that is what the court relies on to place liens subsequent after the mortgage has been placed, and that was how sub-contractors leapfrog ahead in front of the mortgage as the first unsatisfied lien holder. Ms. Olson stated that it was her understanding that by amending K.S.A. 60-1101, which is the contractors sub-section, also affects K.S.A. 60-1103. Ms. Olsen stated she would have the attorneys review this.

Senator Bruce gave another scenario of a contractor that comes in, does work, perhaps the site runs out of money so they get a mortgage on the project. The lending institution comes in, sees the concrete is poured, and they go ahead and pay off the first contractor, then other contractors come in later. Senator Bruce was concerned that the understanding would be that the other subcontractors would go ahead of the first mortgage. Ms. Olsen stated that currently, and what happened in the *Mutual* case was, the lending institution paid off the contractor that came before the mortgage lender, the lender obtained a lien assignment, and the court said that everyone still gets to piggyback relief off of the original lien because the lender didn't get a lien waiver. In fact the lender needed to obtain lien waivers from everyone. Senator Bruce asked if this would only come into play if the first contractor was unsatisfied, or whether he was paid or not. Ms. Olsen stated that this is the problem. The norm is that before a mortgage is given, any work done prior to the mortgage being effective is paid for, so that there are no prior liens and the institution lending the money is the first lien holder.

Matthew Goddard, testifying on behalf of the Heartland Community Bankers Association, stated the *Mutual* case upset the long-term understanding of the law as it relates to priority of materialman's liens. Additionally, the *Mutual* Case clouded the issue of what is "lienable" work, and identified seven standards of what constitutes lienable work. (Attachment 4)

Opponents:
William Larson, representing the Associated General Contractors of Kansas (AGC), testified that the AGC opposes the bill. The AGC takes the position that the amendments proposed to the lien laws are not necessary, that there are existing ways for financial institutions to protect themselves when financing a project. (Attachment 5)

Woody Moses stated that he represents three different organizations and asked the Committee to review the written testimony submitted on behalf of the Kansas Ready Mixed Concrete Association, Kansas Aggregate Producers Association, and the Kansas Cement Council. (Attachments 6-8)

MINUTES OF THE Senate Judiciary Committee at 9:30 A.M. on February 10, 2005, in Room 123-S of the Capitol.

Clinton Patty testified on behalf of the Kansas Aggregate Producers Association and the Kansas Ready Mixed Concrete Association. Mr. Patty stated that the Associations are opposed to the bill because it seeks to substantially change the state's lien laws, depriving subcontractors of substantial protections guaranteed mostly to small businesses. The bill would be overturning what the Kansas Supreme Court established in the *HAZ-Mat* case. Section 2, under K.S.A. 60-1103, causes problems by changing the verbiage. If a project goes bad and there is not enough money to pay everyone, the sub-contractors should be higher up in the lien sequence, as they are not in a position financially to absorb the loss if their liens are not paid. (Attachment 9)

Chairman Vratil asked whether Mr. Patty and the Associations would react favorably to a proposal which would require a contractor or sub-contractor to file a one-page notice of lien with the Register of Deeds, indicating the description of the project, the date labor and materials were first supplied, and an estimate of the value of the goods and services. Mr. Patty stated that they are not without sympathy for the Bankers and other lien holders in the state and believe something could be worked out without unraveling thirty years of lien laws. Chairman Vratil suggested that the interested parties present get together and try to work out something that will be acceptable to all parties, and perhaps explore the method that Nebraska is using.

Testimony in opposition to the bill was provided in writing from Gus Rau Meyer, President, Rau Construction Company. (Attachment 10)

Chairman Vratil adjourned the meeting at 10:30 A.M. The next meeting is scheduled for February 14, 2005.

Please Continue to Route

SENATE JUDICIARY COMMITTEE GUEST LIST

DATE: 2/10/05

NAME	REPRESENTING
Michael White	KCDAA
Bob Alderson	South Western Assoc
Tom Whitaker	Ks Motor Carriers Assn
Scott Heidner	KADC
Kevin Barone	KTLA
Matt Goddard	Heartland Community Bankers Assoc.
Jim Clark	KBA
Stan Jackson	Insurance Planning Inc
Woody Moses	Ks Cement Council
Clint Patty	KAPA
Wendy Harms	KRMCA
Jeannie Goodwin	City of Wichita
Dennis Hadley	Denison State Bank Meriden Branch - Holton Hays
Kathy Olsen	KS Bankers Assn.
Tom Slattery	AGC / Ks
Corey Peterson	AGC KS
Will Larson	AGC KS

Kansas Independent Oil & Gas Association
800 SW Jackson Street – Suite 1400
Topeka, Kansas 66612
Phone 785-232-7772 Fax 785-232-0917
Email: kiogaed@swbell.net

Testimony to the Senate Judiciary Committee
Senate Bill 97 – An Act concerning construction contracts; relating to indemnification provisions

Edward P. Cross, Executive Vice President
Kansas Independent Oil & Gas Association

February 10, 2005

Good Morning Chairman Vratil and members of the committee. I am Edward Cross, Executive Vice President of the Kansas Independent Oil & Gas Association, and I am happy to be here today to express our support for Senate Bill 97 (SB 97).

Insurance companies often require oil & gas lease operators to utilize Master Service Agreements (MSA) whenever they contract for services from third party contractors. The primary purpose of the MSA is to 1) reaffirm the contractor relationship, 2) require the contractor to provide proper insurance including Workers Compensation for their employees, and 3) to hold harmless and indemnify the operator from general liability cases. The problem stems from the fact that many large oil and gas companies, under advice from their legal counsel, have added other provisions to the MSA that cause significant concerns, expense, and legal requirements that conflict with other contractual obligations of the contractor or operator.

SB 97 amends K.S.A. 2004 Supp. 16-121 to include oil and gas exploration and production activities in the definition of a construction contract. SB 97 augments last year's HB 2154 which addressed indemnification provisions for construction contracts along with other railroad issues. SB 97 would disallow any hold harmless or indemnification agreement that called for a contractor to protect the operator if a claim of negligence were made against the operator. Our goal is to make the MSA or MSA-like concepts against public policy and void and unenforceable. We urge the committee to pass SB 97.

Senate Judiciary
2.10.05
Attachment 1

Testimony on Senate Bill 97
Stanley Jackson
3006 Broadway
Hays, Ks 67601
February 10, 2005

Thank you for allowing me the opportunity to appear before this committee today in support of Senate Bill 97. My name is Stanley Jackson and I am the senior vice president and commercial lines sales manager for Insurance Planning, Inc. of Hays, Kansas. We are a large provider of commercial property and casualty insurance coverage with a significant number of our customers being oil field service contractors.

One area of concern raised by several of our customers involves oil and gas company service contracts that require the servicing contractor to indemnify the oil company for the oil company's negligent injury of the servicing company's employees. A hold harmless or indemnification clause is the assumption, by contract, by the one party (the "Indemnitor") of the liability of another party (the "Indemnitee"), arising out of the contract.

House Bill 2154 addressed this issue in 2004 and found construction contracts that require these type of hold harmless or indemnification provisions would be void and unenforceable as against public policy. My clients are merely asking that as oil field contractors that they be given the same protection.

Insurance rates for my customers are determined by many factors and one of the major factors is the amount of claims that the insurance carrier must pay on behalf of that customer. Contractors can implement a safety program and maintain a safe working environment for their employees, but they have no control over the locations of the oil companies that hire the contractor to provide services at those locations. By allowing the oil company to transfer the risk, by using the type of indemnification provision that we are discussing, undermines everything that my contractors are trying implement in their safety programs and takes away the incentive for the oil company to provide a safe working environment for my contractor's employees.

The general liability policy excludes liability for claims of employees and for most contractual liability. In addition, some insurance carriers are using specific employer's liability exclusions to be attached to the general liability policy that makes it impossible for my contractor to insure this exposure.

We are merely asking that each party be responsible for their own acts of negligence and not be allowed to shift that responsibility by contract. Senate Bill 97 is legislation that ensures each party is responsible for their own acts of negligence. Thank you for allowing me to address this committee and I would be happy to answer any questions.

Respectfully submitted,
Stanley Jackson
Senior Vice President
Insurance Planning Inc

Senate Judiciary
2-10-05
Attachment 2

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

February 10, 2005

To: Senate Committee on Judiciary

From: Kathleen Taylor Olsen, Kansas Bankers Association

Re: SB 112: Materialman's Lien Statute

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before you today to in support of **SB 112**, a bill that amends several statutes relating to the priority of Kansas materialman's liens. These amendments are the result of a collaborative effort among the Kansas Land Title Association, the Heartland Community Bankers Association and the Kansas Bankers Association. This bill draft represents this group's attempt to address a recent Kansas Court of Appeals decision, *Mutual Savings Assoc. v. Res/Com Prop.*, 32 Kan. App. 2d 48, 79 P.3d 184 (2004).

K.S.A. 60-1101, establishes the basis for determining priority of claims against property under construction. We believe that this statute provides that all unpaid materialmans' liens relating to the same improvement have equal rank with one another, and that all have priority over any other lien that is recorded subsequent to the commencement of visible work on the property.

There are two very important keys to this law: 1) that the priority for materialmans' liens over other liens is measured from the date that the earliest **unpaid** lienholder began work on the property, and not the date work began by some party who has been paid in full; and 2) that the work establishing the priority date for all other lienholders must be something that is **visible** at the property site.

The Court in the *Mutual Savings* case cast doubt on the reliability of the law as we know it to be. The Court decision indicates that the priority date for all subsequent lienholders under this law can be established by a contractor or subcontractor who has been paid in full and no longer has a claim on the property; and that work that is not visible can establish the priority date for all other subsequent lienholders under this law.

We believe that these amendments are necessary to re-establish the long-understood rule that allowed a mortgagee to ensure the priority of the recorded mortgage against unknown lienholders under this law by: 1) providing that those who have been paid in full and who no longer have a claim on the property cannot establish the priority date for subsequent lienholders; and 2) requiring that the work done on the property which establishes the priority date for all subsequent lienholders be visible, thereby giving notice to the world that there may be lien claims on the property.

Thank you and we would respectfully request that the Committee act favorably on **SB 112**.

610 SW Corporate View 66615 • P.O. Box 4407, Topeka, KS 66604 • (785) 232-3444 • FA
email kbaoffice@ink.org

Senate Judiciary
2-10-05
Attachment 3

HEARTLAND COMMUNITY BANKERS ASSOCIATION

Matthew S. Goddard, Vice President

700 S. Kansas Ave., Suite 512
Topeka, Kansas 66603
Office (785) 232-8215 • Fax (785) 232-9320
mgoddard@hcbankers.com

To: Senate Judiciary Committee

From: Matthew Goddard
Heartland Community Bankers Association

Date: February 10, 2005

Re: Senate Bill 112

The Heartland Community Bankers Association appreciates the opportunity to appear before the Senate Committee on Judiciary to express our support for Senate Bill 112.

The Heartland Community Bankers Association represents savings associations in Kansas, Arkansas, Colorado, Nebraska and Oklahoma. Our Kansas membership makes more than $250 million in construction loans annually for residential and commercial properties.

A ruling by the Court of Appeals in *Mutual Savings Association v. Res/Com Properties*, 32 Kan. App. 2d 48, 79 P.3d 184 (2004), has caused concern among Kansas lenders and has the potential to jeopardize future construction lending. The ruling upset our long-term understanding of Kansas law as it relates to the priority of materialman's liens. We believe Senate Bill 112 is a fair attempt to protect the interests of lenders, contractors and subcontractors. By providing for the interests of these three groups, we are also serving the interests of the owners of the property being constructed.

Currently, K.S.A. 60-1101 provides the basis for determining the priority of materialman's liens. The first lien can be filed when labor, equipment, material or supplies are used or consumed for the improvement of real property. The lien enjoys priority over all other liens which are subsequent to the start of the furnishing of labor, equipment, material and supplies at the property that is the subject of the lien. When two or more liens are filed on the same improvement, all of the liens are similarly preferred to the date of the earliest unsatisfied lien. A 1990 appellate court ruling upheld the long-time standard that any improvements to the property must be visible. This was so everyone would know lienable work had been performed.

In the *Mutual* case, the court found that even when Mutual Savings, which had second priority with its mortgage, paid the contractor with first lien priority and took assignment of its priority lien, the liens of contractors who subsequently performed lienable work still had priority over Mutual because of the "piggy-back" effect of materialman's liens. The court essentially said that the "earliest unsatisfied lien" remains so even after it is paid off. It was the expectation of our industry that Mutual would have first priority after paying the original lienholder and taking assignment of its lien.

HCBA is also concerned because the *Mutual* ruling seems to permit liens for work which is not visible and allows those liens to set the priority date for subsequent lienholders. Prior to *Mutual*, and affirmed in a 1977 opinion, work performed at a site constituted notice of the existence of the lien. Post-*Mutual*, we now live in an era of uncertainty as that standard seems to no longer be valid. Lenders are concerned that they may no longer know when lienable work has commenced.

Senate Judiciary
2-10-05
Attachment 4

Senate Bill 112 requires that lienable work must be visible at the site of the property subject to the lien. The bill also provides that if an earlier unsatisfied lien is paid in full, the preference date for everyone with a claim becomes the date of the next earliest unsatisfied lien.

The ruling in *Mutual v. Res/Com* does not impact the vast majority of construction projects where the lender who is financing the construction files its lien prior to the commencement of work on the property. However, in instances where work begins or supplies are furnished before the lender files its lien, the uncertain presence of materialman's liens risks the project's financing. Although the Court of Appeals stated that lenders may protect the priority of their mortgage by obtaining lien waivers, any risk associated with that process may prompt the lender to abandon the project altogether. HCBA believes that by allowing the status quo to remain in place, lenders will be more likely to withdraw financing than risk losing out on the priority of its claim.

We respectfully request that the Senate Committee on Judiciary recommend SB 112 favorable for passage.

Thank you.

TESTIMONY OF WILLIAM A. LARSON,
GENERAL COUNSEL TO THE ASSOCIATED
GENERAL CONTRACTORS OF KANSAS
TO THE SENATE JUDICIARY COMMITTEE ON
SENATE BILL 112

The Associated General Contractors of Kansas, is an Association consisting of the majority of commercial general contractors (other than in Wyandotte and Johnson County) in the construction building industry. The Association, however, does not just represent general contractors. It also has in Kansas a large number of subcontractor members as well as associate members including material suppliers who have lien rights under our current mechanics liens laws. The Associated General Contractors of Kansas (AGC) opposes Senate Bill No. 112.

Senate Bill No. 112 is a reaction to the Kansas Court of Appeals case of *Mutual Savings Association v. Res /Com Properties, LLC, et al.*, 32 Kan.App.2d 448, 79 P.3d 184 (2003). In this case, Mutual Savings Association was attempting to foreclose on its mortgage against the owner of a project that defaulted on payments to Mutual Savings as well as to its contractor and subcontractors. Succinctly put the Court of Appeals held that the Mutual Savings Association did not have a first and prior lien to the mechanic's lien claimants and further held that it was not absolutely necessary that work on the site be visible prior to a mechanic's lien attaching. While it would probably not be productive to go into a detailed explanation of the *Mutual Savings Association* case, it suffices to say that the situation that occurred in the *Mutual Savings* case, was very unusual.

The AGC of Kansas has historically opposed changes to the mechanic's lien laws unless there was a very good reason for them. The reason is that the mechanic's lien laws are currently understood as a result of industry practice and numerous court interpretations of the law. Any time a change is made in the lien laws, it often results in multiple court decisions before the changes or the effects of those changes can be accurately evaluated by those involved in commercial construction industry in Kansas.

The AGC would agree with the Kansas Bankers Association and other financial institutions who support this law to the extent that where a project is financed, the financing entity would normally have a first and prior lien. In most cases, this is not an issue because the project does not go forward until the financing is in place. The problem in the *Mutual Savings* case was that because of a change in ownership work had been done on the project prior to the mortgage being filed. We believe that under existing laws, there was a very clear

means of protecting Mutual Savings' interest. Mutual Savings could have and should have obtained lien waivers from all of those who had performed any work on the project prior to filing the mortgage. It is our understanding that it is common practice for financial institutions to determine exactly what work, if any, has been done on a project prior to filing a mortgage and obtaining lien waivers or lien subordination agreements pertaining to those entities. In this case, Mutual Savings simply failed to do that for whatever reason. We do not believe it is appropriate to change the lien laws to try and alleviate a situation that normally would not and should not occur. The effect of the change advocated for K.S.A. 60-1101 would be to allow any party to change the preference date of all lien claimants after all of the encumbrances have been filed and during foreclosure procedures. This would involve what we believe would be a fairly drastic change in the lien laws which historically have stated that all mechanic's lien claimants are similarly preferred to the date of the earliest unsatisfied lien when the liens are filed. We do not believe that the law should be changed in reaction to a single case which involves a very unusual circumstance.

In addition, we also agree with the analysis of the Court of Appeals in the *Mutual Savings Association* case which held that in certain circumstances, lienable work may attach even though there is no visible change in the property. As noted in the Mutual Savings cases, companies can expend significant amounts of money in doing work on a project, some of which may include alterations to the site which are not readily visible. Certainly, we adamantly disagree with the language proposed in the change to K.S.A. 60-1101 which states "The placement of a sign or survey stakes at the site shall not constitute the 'visible furnishing' of labor, equipment, material and supplies.

In short, the AGC takes the position that the amendments proposed to the lien laws in Senate Bill No. 112 are simply not necessary. There are existing ways for financial institutions to protect themselves when financing a project.

800 S.W. Jackson Street, #1408
Topeka, Kansas 66612-2214
(785) 235-1188 • Fax (785) 235-2544

KRMCA

Kansas Ready Mixed
Concrete Association

Edward R. Moses
Managing Director

TESTIMONY

Date: February 10, 2005

Before: The Senate Committee on Judiciary

By: Woody Moses, Managing Director
Kansas Ready Mixed Concrete Association

Regarding: Senate Bill #112 – An act concerning Materialman's Liens

Good Morning Mr. Chairman and Members of the Committee:

My name is Woody Moses, Managing Director of the Kansas Ready Mixed Concrete Association. The Kansas Ready Mixed Concrete Association (KRMCA) is an industry wide trade association comprised of over 175 members located or conducting operations in all 165 legislative districts in this state, providing basic building materials to all Kansans. I appreciate the opportunity to appear before you today in reluctant opposition to SB 112.

Reluctant because while we support the concept that every lender should have a reasonable expectation of security as a prerequisite to funding a construction or any other project for that matter; SB 112 is not the answer. Specifically we have problems with the term "visible" (page 1, line 25) and further definitions of what items are visible or not (page 1, line 33). In the context of our industry, preliminary work is not always visible such as concrete test cores, which are sometimes buried in the ground or underground base rock depending upon the phase of a project. Frankly it appears to us that SB112 would upset a large number of long standing procedures associated with an act that has met the test of time in providing order in the construction marketplace.

At this point in time I would like to introduce our legal counsel Clint Patty, of Frieden, Haynes & Forbes to discuss his analysis of this bill made at our request.

While we cannot support SB 112 in its current form we stand ready to work with all parties to achieve an equitable compromise. Thank you for your attention to our testimony.

Senate Judiciary
2-10-05
Attachment 6

800 S.W. Jackson Street, #1408
Topeka, Kansas 66612-2214
(785) 235-1188 • Fax (785) 235-2544

KAPA

Kansas Aggregate
Producers' Association

Edward R. Moses
Managing Director

TESTIMONY

Date: February 10, 2005

Before: The Senate Committee on Judiciary

By: Woody Moses, Managing Director
Kansas Aggregate Producers Association

Regarding: Senate Bill #112 – An act concerning Materialman's Liens

Good Morning Mr. Chairman and Members of the Committee:

My name is Woody Moses, Managing Director of the Kansas Aggregate Producers Association. The Kansas Aggregate Producers Association (KAPA) is an industry wide trade association comprised of over 170 members located or conducting operations in all 165 legislative districts in this state, providing basic building materials to all Kansans. I appreciate the opportunity to appear before you today in reluctant opposition to SB 112.

Reluctant because while we support the concept that every lender should have a reasonable expectation of security as a prerequisite to funding a construction or any other project for that matter; SB 112 is not the answer. Specifically we have problems with the term "visible" (page 1, line 25) and further definitions of what items are visible or not (page 1, line 33). In the context of our industry, preliminary work is not always visible such as concrete test cores, which are sometimes buried in the ground or underground base rock depending upon the phase of a project. Frankly it appears to us that SB112 would upset a large number of long standing procedures associated with an act that has met the test of time in providing order in the construction marketplace.

At this point in time I would like to introduce our legal counsel Clint Patty, of Frieden, Haynes & Forbes to discuss his analysis of this bill made at our request.

While we cannot support SB 112 in its current form we stand ready to work with all parties to achieve an equitable compromise. Thank you for your attention to our testimony.

Senate Judiciary
2-10-05
Attachment 7

KANSAS CEMENT COUNCIL

800 SW Jackson – 1408
Topeka, Kansas 66612
785-235-1188

TESTIMONY

Date: February 10, 2005

Before: The Senate Committee on Judiciary

By: Woody Moses, Kansas Cement Council

Regarding: Senate Bill #112 – An act concerning Materialman's Liens

Good Morning Mr. Chairman and Members of the Committee:

My name is Woody Moses, representing the Kansas Cement Council. The Kansas Cement Council is composed of the four cement mills operating in Southeast Kansas. I appreciate the opportunity to appear before you today in reluctant opposition to SB 112.

Reluctant because while we support the concept that every lender should have a reasonable expectation of security as a prerequisite to funding a construction or any other project for that matter; SB 112 is not the answer. Specifically we have problems with the term "visible" (page 1, line 25) and further definitions of what items are visible or not (page 1, line 33). In the context of our industry, preliminary work is not always visible such as concrete test cores, which are sometimes buried in the ground or underground base rock depending upon the phase of a project. Frankly it appears to us that SB112 would upset a large number of long standing procedures associated with an act that has met the test of time in providing order in the construction marketplace.

At this point in time I would like to introduce our legal counsel Clint Patty, of Frieden, Haynes & Forbes to discuss his analysis of this bill made at our request.

While we cannot support SB 112 in its current form we stand ready to work with all parties to achieve an equitable compromise. Thank you for your attention to our testimony.

Senate Judiciary
2-10-05
Attachment 8

TESTIMONY

By

Clinton E. Patty

Before the

Senate Judiciary Committee

Regarding SB 112

February 10, 2005

Chairperson Vratil, members of the committee, my name is Clint Patty. I am an attorney with the law firm of Frieden, Haynes and Forbes in Topeka, Kansas, and am here representing my clients, the Kansas Aggregate Producers Association and the Kansas Ready Mixed Concrete Association. I have been asked to provide testimony in opposition to S.B. No. 112, which seeks to substantially change our state's lien laws, depriving subcontractors of substantial protections guaranteed to these mostly small businesses.

S.B. 112 represents a "knee-jerk" reaction by the banking industry to a 2003 decision by the Kansas Court of Appeals, Mutual Savings Association v. Res/Com Properties, LLC, et al., 32 Kan.App.2d 48, 79 P.3d 184 (Kan.App. 2003), rev. denied, 2004. The primary problem with this bill is that is does much more than overturn Mutual Savings, effectively reversing three decades of lien law development in the state of Kansas. These developments serve an important purpose of protecting the "little guy", largely small business subcontractors who need the security of the current law to protect their businesses. Passage of S.B. 112 in its current form will represent an unnecessary shift in the law, favoring big banking interests over small business. Significantly, regardless of whether or not Mutual Savings remains precedent in Kansas, the proposed changes are unnecessary to protect the interests of the banking industry. This testimony will provide a brief history of the development of lien-holder priority law in Kansas, why this development is good for small business and finally why S.B. 112 is both harmful and unnecessary.

Historically, Kansas mechanics lien statutes at K.S.A. 60-1101, et seq. have provided that once a lien has attached, it is superior to any subsequent purchaser for value. The "improvement to the property" itself constitutes notice to the world of the existence of the lien. Lenexa State Bank & Trust Co. v. Dixon, 221 Kan. 238, 241, 559 P.2d 776 (1977). Additionally, regardless of when a subcontractor commences work on real property, their lien rights "relate back" to the prime contractor's date of lien. Because the statute does not define "improvement of real property", the Kansas Supreme Court in Haz-Mat Response, Inc. v. Certified Waste Services Ltd., 259 Kan. 166, 170, 910 P.2d 839 (1996), devised seven (7) considerations for determining if an activity is considered to improve real property:

(1) What is or is not an improvement of real property is based upon the circumstances of each case;
(2) improvement of the property does not require the actual construction of a physical improvement on the real property;
(3) the improvement of real property ***need not necessarily be visible***, although in most instances it is;
(4) the improvement of the real property must enhance the value of the real property, although it need not enhance the selling value of the property;
(5) for labor, equipment, material, or supplies to be lienable items, they must be used or consumed and thus become part of the real property;
(6) the nature of the activity performed is not necessarily a determining factor of whether there is an improvement of real property within the meaning of the statute; rather, the purpose of the activity is more directly concerned in the determination of whether there is an improvement of property which is thus lienable; and
(7) the furnishing of labor, equipment, material, or supplies used or consumed for the improvement of real property ***may become lienable if established to be part of an overall plan to enhance the value of the property, its beauty or utility, or to adapt it for a new or further purpose***, or if the furnishing of labor, equipment, material, or supplies is a necessary feature of a plan of construction of a physical improvement to the real property.

For subcontractors across the state, the ability to establish priority lien rights is essential. The above factors, especially those recognizing that rights can attach even if the work is not "visible" is vital to those in the concrete and rock industry. These small businesses often perform improvements on property that may not be visible, but are essential to the overall improvement of real property.

Proponents of S.B. 112 are obviously responding to Mutual Savings, which held that a general contractor's preliminary staking and surveying constituted an "improvement" under K.S.A. 60-1101. This meant that the general contractor, along with all subcontractors lien rights were superior to the bank's mortgage where the bank did not obtain lien waivers.

While it is certainly understandable that the banking industry would be concerned with the Court's ruling, they are not without a remedy under the law. As the Court in Mutual Savings noted, the bank could have simply demanded lien waivers from the contractors prior to securing financing. This renders the entire bill unnecessary and overly burdensome. Further, since the Mutual Savings decision is limited to "preliminary staking and surveying", all that is needed would be a clarification that K.S.A. 60-1101 does not apply to the placement of signs or survey stakes. However, S.B. 112 goes much further, dismantling three decades of protections for subcontractors across the state. First, S.B 112 provides that materials or services provided by contractor or subcontractors must be "visible" to effect lien rights. This is provided without any definition on what constitutes a "visible" improvement on real property. For many subcontractors, especially in the concrete industry, this bill would mean they would lose lien rights for

work performed that is necessary and essential for improvements, but not necessarily visible.

Second, Section 2 of the bill totally dismantles the lien priority system that has existed for three decades. By providing that "the preference date for all claimants shall be the date of the next earliest unsatisfied lien", subcontractors lose their priority once other liens are paid. Subcontractors should be able to rely upon having the same priority date as the general contractor. While the proposed changes may not have anticipated these consequences, the bill should be rejected primarily because it is unnecessary to alleviate the concerns raised by the holding in Mutual Savings.

On behalf of the subcontractors I represent here today, I hope you will vote against this unnecessary, and ultimately harmful change in the rights of small business owners across the state.

Thank you for allowing me the opportunity to provide my clients' position on this important matter.

RAU CONSTRUCTION CO.
SINCE 1870
Engineers and Contractors
913-642-6000/FAX 913-642-6031
9650 NALL AVENUE
OVERLAND PARK, KANSAS 66207-2979
mail@rauconstruction.com

TESTIMONY BEFORE **THE SENATE**

JUDICIARY COMMITTEE

ARGUMENTS AGAINST SB 112
CONCERNING REVISED LANGUAGE FOR LIEN LAWS
BY GUS RAU MEYER
FEBRUARY 10, 2005

My name is Gus Meyer, President of Rau Construction Company in Overland Park. Rau was founded in 1870, and is a mid-size General Contractor working on commercial, retail, office and historic rehabilitation projects. I am not able to submit this testimony in person, but urge your consideration in opposition to Senate Bill 112. Construction Lien laws, like those used in Kansas for commercial construction, are one of the laws that are universally understood and work well if followed. They provide protection for the Owner of a project and clearly tell him/her how gain this protection. They also provide protection for Subcontractors and Suppliers from Owners or Contractors who do not pay their bills. This legislation would change a system that has been working for decades. A system that is fair to all parties involved.

The changes to the language requiring that require "visible" work to be performed on a project before a claim could be made is troubling. Quite often, substantial work is performed before there is any "visible" evidence of work on the jobsite. An example would be structural steel work where the shopdrawing and fabrication stage may be 75% of the total cost of that subcontractors work, and none of it would be "visible" on the project site before they started erection on the site. In fact, almost every trade will have work they do, that is lienable, before they set foot on a project site.

The language on "preferences" is also problematic. The current application of lien laws says that all subcontractors and suppliers have the same standing, regardless of when the "arrived" on the job. Giving someone who was on site early in the project preference in getting paid over someone who arrived later in the project is an onerous burden for those who had to wait to start their portion of the project until those before them had completed their work. I do not think this is the intended consequence that the legislature would want if this were passed.

Again, I urge you to seriously consider the details in Senate Bill 112, and oppose this proposed legislation. I apologize for not being able to submit this testimony in person. If you have any questions on what I have prepared, please feel free to contact me at my office (913-642-6000).

Senate Judiciary
2-10-05
Attachment 10