

# Comments

## CALIFORNIA MECHANICS' LIENS\*

[If a man were in the mood to be sensual, he would be aroused by the Mechanics' Liens Acts.<sup>1</sup>

A mechanics'<sup>2</sup> lien is a charge imposed upon specific real property as security for the remuneration of those who have contributed labor or materials to the improvement of the property.<sup>3</sup> The lien is a creature of statute that was unknown at common law or in equity;<sup>4</sup> nevertheless provision for the lien is made in the state constitution.<sup>5</sup> Although the present statutes follow a pattern established in 1911,<sup>6</sup> mechanics' lien law has been subjected to almost interminable piecemeal amendment. One result of the amendment process is clear. The statutes today are incredibly complex<sup>7</sup> and become comprehensible only after arduous study.

In this comment, present mechanics' lien law is subjected to a detailed analysis, with a view toward reform. For convenience, an outline of the comment follows:

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\* Numerous practicing attorneys were consulted in the preparation of this comment. The authors appreciate the time and effort that each expended. In particular, two of the leading mechanics' lien lawyers in California acted in an advisory capacity—Mr. Glen Behymer and Mr. Richard C. Dinkelspiel. Mr. Dinkelspiel was Chairman of the Committee to Study 1958 Conference Resolution No. 70. The views expressed in this comment, except where otherwise expressly stated, are not necessarily those of either Mr. Behymer or Mr. Dinkelspiel.

The Committee to Study 1958 Conference Resolution No. 70 (study of the mechanics' lien laws) was made up of lawyers throughout the state and was divided into subcommittees by subject matter and by geographic area. The committee study was conducted over four years; the committee report is contained in State Bar of California, Final Report of Committee to Study 1958 Conference Resolution No. 70, Sept. 11, 1962 (unpublished report in University of California Law School Library, Berkeley) [hereinafter cited as State Bar Report]. Because the committee believed that it did not have adequate resources, it concluded that the study should be referred to an interim committee of the state legislature or to the Law Revision Commission.

<sup>1</sup> Book Review, *Time*, Oct. 19, 1962, p. 96. This remark was made by the late Justice Curtis Bok of the Pennsylvania Supreme Court "while discussing the unnecessary pothole raised by bluenoses about sex in literature." *Ibid.*

<sup>2</sup> "Mechanic" is used in its older sense to mean "laborer" or "workman."

<sup>3</sup> See CAL. CODE CIV. PROC. §§ 1180, 1181, 1184.1.

<sup>4</sup> *Spinney v. Griffith*, 98 Cal. 149, 32 Pac. 974 (1893). England has never recognized, and does not today recognize, the lien.

<sup>5</sup> CAL. CONST. art. XX, § 15.

<sup>6</sup> Cal. Stats. 1911, ch. 681, p. 1313.

<sup>7</sup> See, e.g., CAL. CODE CIV. PROC. § 1190.1.

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## I

## THE PRESENT SCHEME

Although the California constitution is a source of mechanics' liens, the constitutional provision is not self-executing.<sup>8</sup> Consequently, the analysis of these liens is concerned primarily with the statutes by which the legislature has provided for the execution of the constitutional lien and by which the legislature has provided for a purely statutory lien.<sup>9</sup> These statutes are contained in chapter 2 of title IV of the Code of Civil Procedure.<sup>10</sup> Chapter 2, however, contains two separate security devices that properly may be termed mechanics' liens—those of section 1181 and those of section 1184.1. Unless otherwise specifically stated, this portion of the comment discusses liens provided by section 1181. Section 1184.1 liens are considered separately.<sup>11</sup> In addition, chapter 2 provides for the stop notice, another security device available to an improver of real property other than the prime contractor. The stop notice is probably not a mechanics' lien at all since it is not a lien on real property but upon funds in the hands of the owner or his agent, in the nature of an equitable garnishment. Unless otherwise specifically stated, the discussion below is concerned with the liens provided for by section

<sup>8</sup> *E.g.*, *Spinney v. Griffith*, 98 Cal. 149, 32 Pac. 974 (1893); see note 238 *infra*.

<sup>9</sup> The legislature in the exercise of its police power may provide for a purely statutory lien. *Mendenhall v. Gray*, 167 Cal. 233, 139 Pac. 67 (1914).

<sup>10</sup> CAL. CODE CIV. PROC. §§ 1181–203.1.

<sup>11</sup> See discussion in part I, F, following note 128 *infra*.

1181; stop notices are discussed separately.<sup>12</sup> Mechanics' liens, as opposed to stop notices, are available only to improvers of real property that is privately owned, since sovereign immunity precludes asserting the lien on public property. Unless otherwise specifically stated, this portion of the comment is concerned with private and not public construction projects.

### A. Persons Entitled to Mechanics' Liens

Under the basic legislative scheme, the potential mechanics' lien claimant must meet two requirements before he is entitled to a mechanics' lien. First, the claimant must prove that he has a valid contract, express or implied, with the owner. Second, the claimant must prove that he has contributed to a "work of improvement."

#### 1. Valid Contract, Express or Implied

The predicate of any lien is a valid underlying obligation;<sup>13</sup> the lien claimant must prove a valid contract, express or implied, with the owner.<sup>14</sup> Although the necessary contract may be invalidated by the application of the usual contract rules, e.g., lack of mutual assent,<sup>15</sup> the contract also may be rendered unenforceable because one of the parties is not a licensed contractor as required by law.<sup>16</sup>

Where the owner himself has not expressly authorized the work of improvement<sup>17</sup> or the work of the particular claimant,<sup>18</sup> the mechanics' lien claimant may be able to prove the necessary contract by showing that he contracted with an

<sup>12</sup> See discussion in part I, G, following note 145 *infra*.

<sup>13</sup> CAL. CODE CIV. PROC. § 1180 defines a lien as a charge imposed upon specific property as security for the performance of an act.

<sup>14</sup> OGDEN, CALIFORNIA REAL PROPERTY § 16.4 (1956). CAL. CODE CIV. PROC. § 1181 provides that the labor or materials for which the claim is being asserted be "done or furnished at the instance of the owner or of any person acting by his authority or under him, as contractor or otherwise."

<sup>15</sup> McCray v. Wotkins, 41 Cal. App. 449, 182 Pac. 972 (1919).

<sup>16</sup> See CAL. BUS. & PROF. CODE § 7031. "Contractor" for the purposes of the licensing requirement is broadly defined. Thus, subcontractors, CAL. BUS. & PROF. CODE § 7026, and materialmen who install their materials are "contractors," CAL. BUS. & PROF. CODE § 7045, and must obtain a license. Conversely, materialmen who do not install their materials, CAL. BUS. & PROF. CODE § 7052, and laborers, CAL. BUS. & PROF. CODE § 7053, are expressly excluded from the licensing requirement. A claimant who is required to be licensed as a contractor must show that he has substantially complied with the licensing requirements before he can perfect a lien, *Alvarado v. Davis*, 115 Cal. App. 782, 6 P.2d 121 (Super. Ct. App. Dep't 1931), unless he is within a class designed to be protected by the licensing requirement. A licensed contractor cannot recover from the owner for a contract that he enters into with an unlicensed subcontractor because the contract is illegal and is therefore legally unenforceable. *Holm v. Bramwell*, 20 Cal. App. 2d 332, 67 P.2d 114 (1937). But, a materialman who contracts with an unlicensed contractor is nevertheless allowed to perfect a lien, because the materialman is within the class designed to be protected by the licensing requirement. *Petaluma Bldg. Materials, Inc. v. Foremost Properties, Inc.*, 180 Cal. App. 2d 83, 4 Cal. Rptr. 268 (1960); *accord*, *Johnson v. Silver*, 161 Cal. App. 2d 853, 327 P.2d 245 (Super. Ct. App. Dep't 1958) (employee of unlicensed contractor).

<sup>17</sup> The claimant may be able to prove the necessary contract for the work of improvement by statutory estoppel. See note 54 *infra* and accompanying text.

<sup>18</sup> If the owner or his common law agent has authorized the work of the claimant, then he will have met the underlying contract requirement. CAL. CODE CIV. PROC. § 1181 ("at the instance of the owner or of any person acting by his authority or under him, as contractor or otherwise").

agent of the owner. Section 1182(c) provides: "For the purposes of this chapter,<sup>10</sup> every . . . person having charge of the construction, alteration, addition to, or repair, in whole or in part, of any building or other work of improvement shall be held to be the agent of the owner."<sup>20</sup> Thus a materialman will be able to assert a lien if he supplied materials to a subcontractor but he will not be able to assert a lien if he supplied materials to another materialman.<sup>21</sup>

<sup>10</sup> (Footnote added.) It is clear that CAL. CODE CIV. PROC. § 1182(c) creates statutory agency only for the purposes of lien liability and not for the purposes of personal liability. See notes 55-56 *infra* and accompanying text.

<sup>20</sup> Statutory agency lies at the heart of the direct lien statutes, of which the California statute is an example. See CAL. CODE CIV. PROC. § 1185.1(a). The lien is direct in the sense that the claimant is said to have a direct right of lien arising out of his contract with the owner or his agent (common law or statutory). See Comment, 68 YALE L.J. 138, 144 (1958). Although Phillips observed that the resulting "multiplication of liens would become an intolerable nuisance" if parties not in privity with the owner were made statutory agents, PHILLIPS, MECHANICS' LIENS 98 (3d ed. 1893), the California statute nevertheless provides that the subcontractor as well as the contractor is a statutory agent of the owner, CAL. CODE CIV. PROC. § 1182(c). It is quite possible that the legislature intended to make statutory agents only those subcontractors who have "charge of the construction, alteration, addition to, or repair, in whole or in part, of any building or other work of improvement. . . ." CAL. CODE CIV. PROC. § 1182(c). (Emphasis added.) See *Theisen v. County of Los Angeles*, 54 Cal. 2d 170, 183, 352 P.2d 529, 538, 5 Cal. Rptr. 161, 170 (1960), where the court used the italicized words to find one who made custom doors away from the jobsite and did not install them to be a subcontractor. See also Sweet, *Owner-Architect-Contractor: Another Eternal Triangle*, 47 CALIF. L. REV. 645, 671-74 (1959), where the author points out that in states with statutes similar to that of California, architects are not statutory agents because they are not "in charge."

In *Theisen v. County of Los Angeles*, *supra*, the county contracted with *Theisen* for a work of public improvement. *Theisen* then contracted with *Petterson Corporation* for the construction of sixty-four doors to be built to conform to the architect's specifications. *Petterson* in turn contracted with *Durand* for twenty of the doors. *Petterson* failed to pay his bill to *Durand*. *Durand* was not entitled to the stop notice remedy unless he was within a class entitled to a mechanics' lien. CAL. CODE CIV. PROC. § 1190.1(a). The court held that *Petterson* was a subcontractor and hence a statutory agent, so that *Durand* was a person entitled to a lien. Previously, *Petterson* would have been considered to be a materialman, see, e.g., *Hihn-Hammond Lumber Co. v. Elsom*, 171 Cal. 570, 154 Pac. 12 (1915), so that *Durand* would not have been a person entitled to a lien, see authorities cited note 21 *infra*. *Theisen* illustrates the difficulty in determining whether a given individual is a statutory agent. The supreme court, delivering a "definitive holding," stated that (1) a subcontractor is a statutory agent; (2) a person is a subcontractor because he has charge of a part of the work of improvement as required by § 1182(c); and (3) a person has charge of a part of a work of improvement because he is a subcontractor. 54 Cal. 2d at 183, 352 P.2d at 537, 5 Cal. Rptr. at 169. Where this leaves the law seems somewhat unclear. The court may have been saying that the test of whether a person is a subcontractor is whether that person has charge of a part of the work of improvement. If so, then the language of § 1182(c) means that any person who has charge of a part of a work of improvement is a statutory agent. CAL. CODE CIV. PROC. § 1182(c) ("every contractor, subcontractor, architect, builder, or other person having charge of the construction . . ."). (Emphasis added.) If this is so, then any person has a lien who deals with any person who has charge of a part of a work of improvement. The number of parties to which this would extend the lien remedy approaches incomprehensibility. Suppose that the homeowner contracts for the construction of a house. The contractor subcontracts the task of building doors especially for the house. The subcontractor in turn subcontracts the bedroom doors. This subcontractor in turn subcontracts the construction of the door to the master bedroom to still another subcontractor. This last subcontractor, "in the course of performance of the prime contract . . . constructs a definite, substantial part of the work of improvement in accord with the plans and specifications of such contract . . ." 54 Cal. 2d at 183, 352 P.2d at 537-38, 5 Cal. Rptr. at 169. Consequently, the materialman—of whom probably neither the homeowner, nor the contractor, nor the first two subcontractors ever heard—who supplied nails to the last subcontractor is entitled to a security interest in the owner's property.

<sup>21</sup> *Wilson v. Hind*, 113 Cal. 357, 45 Pac. 695 (1896); *Harris & Stunston v. Yorba Linda Citrus Ass'n*, 135 Cal. App. 154, 26 P.2d 654 (1933).

## 2. Contribution to a "Work of Improvement"

The "work of improvement" concept has been described as the foundation of the present scheme.<sup>22</sup> The current system and indeed the constitutional provision for mechanics' liens<sup>23</sup> can be supported, if at all, only by the theory that a person should be permitted to follow his contribution of labor or material to the improvement into which his contribution has been incorporated.<sup>24</sup> This theory seems to be the foundation of section 1181, which states:

[A]ll persons<sup>25</sup> . . . [1] performing labor upon or bestowing skill or other necessary services on, or [2] furnishing materials to be used or consumed in, or [3] furnishing appliances, teams or power contributing to the construction, alteration, addition to, or repair, either in whole or in part, of any building, structure, or other work of improvement shall have a lien. . . .

A potential claimant must establish that he has in some manner contributed to a "work of improvement." A building or a structure is a "work of improvement,"<sup>26</sup> as is

[1] the construction, alteration, addition to, or repair, in whole or in part, of any building, wharf, bridge, ditch, flume, aqueduct, well, tunnel, fence, machinery, railroad, or wagon road, [2] the seeding, sodding, or planting of any lot or tract of land for landscaping purposes, [3] the filling, leveling, or grading of any lot or tract of land, [4] the demolition of buildings, and [5] the removal of buildings.<sup>27</sup>

Apparently the particular work done by the claimant is not relevant for determining what is a "work of improvement," because, "except as otherwise provided<sup>28</sup> . . . , 'work of improvement' and 'improvement' mean the entire structure or scheme of improvement as a whole."<sup>29</sup> Since the claimant has no lien if he is unable to establish a work of improvement, his lien is destroyed if the improvement in which his labor or materials is incorporated is destroyed without the fault of the owner.<sup>30</sup> But where materials are furnished and actually used in the construction of a building, their subsequent removal for convenience or due to a change in the building plans does not destroy the lien.<sup>31</sup>

<sup>22</sup> State Bar of California, Conference of Junior Members, *Mechanics' Liens: Windfall or Pitfall*, Sept. 6, 1956, p. 6.

<sup>23</sup> CAL. CONST. art. XX, § 15.

<sup>24</sup> See *Hardwood Interior Co. v. Bull*, 24 Cal. App. 129, 140 Pac. 702 (1914). It seems at least arguable that the "contribution" theory proves too much, because it in effect assumes the resulting lien.

<sup>25</sup> (Footnote added.) It would seem immaterial for purposes of being entitled to a lien whether the claimant himself is a contractor, subcontractor, materialman, or laborer. *Theisen v. County of Los Angeles*, 54 Cal. 2d 170, 352 P.2d 529, 5 Cal. Rptr. 161 (1960). *But see* notes 41-44 *infra* and accompanying text. Once the claimant has proved the necessary contract, he need show only that he has contributed to a work of improvement. Whether one is a contractor, subcontractor, materialman, or laborer may, however, be important for other purposes. See, e.g., CAL. CODE CIV. PROC. § 1193.1(b), (c).

<sup>26</sup> CAL. CODE CIV. PROC. § 1181.

<sup>27</sup> CAL. CODE CIV. PROC. § 1182(a).

<sup>28</sup> (Footnote added.) See CAL. CODE CIV. PROC. § 1195.1.

<sup>29</sup> CAL. CODE CIV. PROC. § 1182(b).

<sup>30</sup> *Humboldt Lumber Mill Co. v. Crisp*, 146 Cal. 686, 81 Pac. 30 (1905); *Pilstrand v. Greenamyre*, 34 Cal. App. 799, 168 Pac. 1161 (1917); see *McIntosh v. Funge*, 210 Cal. 592, 292 Pac. 960 (1930) (destruction of building due to fault of owner).

<sup>31</sup> *Pacific Sash & Door Co. v. Bumiller*, 162 Cal. 664, 124 Pac. 230 (1912) (work of improvement itself removed from land); *Johnson v. Smith*, 97 Cal. App. 752, 276 Pac. 146 (1929) (materials removed because of defects in installation work, not because of defects in materials themselves); *California Portland Cement Co. v. Wentworth Hotel Co.*, 16 Cal. App. 692, 118 Pac. 103 (1911) (change in building plans).

To constitute a "work of improvement," apparently the particular improvement upon which the claimant bases his claim must be an improvement of a "permanent character."<sup>32</sup> Whether this requirement is taken very literally by the courts is open to serious question. In *Nolte v. Smith*,<sup>33</sup> the district court of appeal held that underground metal pipes served as "'boundary corners or street monuments or lot monuments which would be permanent corners'" and constituted a work of improvement of a permanent character despite the fact that the project was abandoned without further work. The court reasoned: "Certainly such monuments are as permanent as 'seeding, sodding, or planting . . . for landscaping purposes [or] the filling, leveling, or grading . . . , for which a lien may be had. . . .'"<sup>34</sup>

After the claimant has established a work of improvement, he must show that he has performed labor upon, furnished materials to be used or consumed in, or furnished appliances contributing to the work of improvement.<sup>35</sup> Consequently, a laborer must show that his labor was used directly in the work of improvement.<sup>36</sup> Accordingly, the supreme court has held that the labor of a cook who prepares meals for the men at the jobsite is too remote and indirect.<sup>37</sup> A laborer has no right to a lien for his tools because they are not used or consumed in a particular work of improvement.<sup>38</sup> Since money is not a building material within the meaning of the mechanics' lien laws, no lien can be claimed for the advance of construction funds.<sup>39</sup> But forms used to hold concrete walls in shape until the concrete hardens are a part, though a temporary part, of a building and are consumed in the building.<sup>40</sup>

A laborer need not show that he was hired with respect to a specific work of improvement.<sup>41</sup> A materialman, however, is required to show both (1) that the materials he supplied were actually used or consumed in the particular work of improvement, and (2) that the materials were furnished "to be used or consumed in" the particular work of improvement.<sup>42</sup> Consequently, a materialman selling materials to a contractor in the general course of business without regard to a specific construction job is not entitled to a lien.<sup>43</sup> For the same reason a supplier to a materialman (a materialman's materialman) has been denied a lien.<sup>44</sup>

<sup>32</sup> *Nolte v. Smith*, 189 Cal. App. 2d 140, 11 Cal. Rptr. 261 (1961).

<sup>33</sup> 189 Cal. App. 2d 140, 148, 11 Cal. Rptr. 261, 266 (1961).

<sup>34</sup> *Ibid.*

<sup>35</sup> CAL. CODE CIV. PROC. § 1181.

<sup>36</sup> *Meyers v. Alta Constr. Co.*, 37 Cal. 2d 739, 235 P.2d 1 (1951) (surveyor and civil engineer).

<sup>37</sup> *Clark v. Beyrle*, 160 Cal. 306, 116 Pac. 739 (1911); *McCormick v. Los Angeles City Water Co.*, 40 Cal. 185 (1870); accord, *Linder Hardware Co. v. Kelley*, 93 Cal. App. 17, 268 Pac. 1076 (1928) (one who supplies hay to feed horses at jobsite not entitled to lien either). *But see* CAL. CODE CIV. PROC. § 1181 (including teamsters and draymen).

<sup>38</sup> See *Gordon Hardware Co. v. San Francisco & S.R.R.R.*, 86 Cal. 620, 25 Pac. 125 (1890) (picks and shovels).

<sup>39</sup> See *Glassco v. El Sereno Country Club*, 217 Cal. 90, 17 P.2d 703 (1932).

<sup>40</sup> *Consolidated Lumber Co. v. Bosworth, Inc.*, 40 Cal. App. 80, 180 Pac. 60 (1919); see *Pacific Sash & Door Co. v. Bumiller*, 162 Cal. 664, 124 Pac. 230 (1912) (oil used to lubricate threads or joints); *Snell v. Payne*, 115 Cal. 218, 46 Pac. 1069 (1896) (packaging and crating of materials).

<sup>41</sup> *Ah Louis v. Harwood*, 140 Cal. 500, 74 Pac. 41 (1903).

<sup>42</sup> CAL. CODE CIV. PROC. § 1811. These requirements have been relaxed for tract developments. See discussion in part I, E, following note 101 *infra*.

<sup>43</sup> *Fuller & Co. v. Fleisher*, 63 Cal. App. 78, 218 Pac. 53 (1923); cf. *Nevada County Lumber Co. v. Janiss*, 25 Cal. App. 2d 579, 78 P.2d 200 (1938). In *Nevada County Lumber Co.*, materials under separate contract for two separate buildings were ordered and delivered together. Although the materials were used upon both buildings at the same time and in equal

### B. Property Subject to Mechanics' Liens

Three provisions indicate the property subject to a mechanics' lien: (1) section 15, article XX of the California constitution provides that the constitutional right to a lien shall be "upon the *property* upon which they have bestowed labor or furnished material . . .";<sup>45</sup> (2) section 1181 provides that the lien shall be "upon the *property* upon which they have bestowed labor or furnished materials or appliances . . .";<sup>46</sup> and (3) section 1183.1(a) provides that "the *land* upon which any building, improvement, well or structure is constructed, together with a convenient space about the same, or so much as may be required for the convenient use and occupation thereof, to be determined by the court on rendering judgment, is *also* subject to the lien. . . ."<sup>47</sup>

When the work of improvement concept is coupled with the wording of these three statutory provisions, the irresistible conclusion is that the mechanics' lien attaches primarily to the structure or work of improvement itself, as opposed to the land. In the leading case of *English v. Olympic Auditorium, Inc.*,<sup>48</sup> the California Supreme Court thus said that "the word 'property' as therein [in the constitutional provision] used obviously refers to the building or other structure for which the materials have been furnished or labor bestowed; . . ."<sup>49</sup> and that "a lien may exist on a structure independently of the land upon which it is erected. . . ."<sup>50</sup>

If the person who causes a building or work of improvement to be constructed owns a fee interest in the land at the time the work is commenced, then the lien will attach both to the structure and to the land required for its convenient use and occupation.<sup>51</sup> If, however, such person owns less than a fee, then only the structure and his interest in the land is subject to the lien.<sup>52</sup> Only the structure is subject to the lien if the person who causes the improvement to be made owns no interest in the land at all,<sup>53</sup> although the interest of the "noncontracting" owner may be subject to a lien by virtue of statutory estoppel unless he files a statutory notice of nonresponsibility.<sup>54</sup>

proportion, the court allowed a lien in the amount of one-half cost to be charged to each building. *Cf.* CAL. CODE CIV. PROC. § 1194.1, permitting materialmen to apportion materials in certain circumstances. Section 1194.1 is discussed in notes 105-06 *infra* and accompanying text.

<sup>44</sup> *Wilson v. Hind*, 113 Cal. 357, 45 Pac. 695 (1896); *cf.* *Theisen v. County of Los Angeles*, 54 Cal. 2d 170, 352 P.2d 529, 5 Cal. Rptr. 161 (1960).

<sup>45</sup> (Emphasis added.) The homestead is *not* exempt from the execution or forced sale in satisfaction of judgments obtained on debts secured by mechanics' liens. CAL. CIV. CODE § 1241(1).

<sup>46</sup> (Emphasis added.)

<sup>47</sup> (Emphasis added.)

<sup>48</sup> 217 Cal. 631, 20 P.2d 946 (1933).

<sup>49</sup> *Id.* at 642, 20 P.2d at 951.

<sup>50</sup> *Id.* at 643, 20 P.2d at 951.

<sup>51</sup> CAL. CODE CIV. PROC. §§ 1181, 1183.1(a).

<sup>52</sup> *Ibid.*

<sup>53</sup> *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 20 P.2d 946 (1933).

<sup>54</sup> CAL. CODE CIV. PROC. § 1183.1(b) provides:

Every building or other improvement or work . . . altered or repaired upon any land [and the work or labor done or materials furnished] with the *knowledge* of the owner or of any person having or claiming any estate therein . . . shall be held to have been constructed, performed or furnished *at the instance* of such owner or person . . . and *such interest* owned or claimed shall be *subject to any lien* . . . unless such owner or person . . . shall, within 10 days after he shall have obtained knowledge of such construction, alteration or repair or work or labor [post and file for record a *notice of nonresponsibility*]. . . .

(Emphasis added.)

### C. Personal Liability and Lien Liability

#### 1. Personal Liability

Mechanics' lien law does not impose personal liability;<sup>55</sup> the provisions for statutory agency and statutory estoppel apply only for lien liability purposes.<sup>56</sup>

The leading case, *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 20 P.2d 946 (1933), serves to illustrate most of the rules determining the property that is subject to mechanics' liens. In *English*, the Los Angeles Athletic Club and the Title Insurance and Trust Company owned a parcel of land in Los Angeles. The owners leased the land to Danziger, who assigned the lease to Olympic Auditorium, Inc. The lease and the assignment were duly recorded. By the terms of the lease, the lessee was authorized to construct an auditorium on the leased premises. The lease also provided that mechanics and other persons performing work on the auditorium were given notice that any liens filed by them upon said premises would not in any manner affect the rights of the owner-lessors in the auditorium. The lessee was given no right to remove the auditorium from the leased premises. In addition, the owners duly posted and filed for record a valid notice of nonresponsibility after the commencement of the construction. Soon after the plaintiff claimants filed their claims of lien, Olympic Auditorium, Inc. defaulted in the payment of rent and the lease was terminated. The plaintiffs nevertheless sought to perfect their liens against the owners. In answer to the owners' argument that the liens could attach only to the leasehold interest, the supreme court said:

The theory of mechanics' liens in this state is that the lien attaches primarily to the structure for which the materials have been furnished or labor bestowed, and the lien on the land is merely incidental to the lien on the structure. This distinction between land and superstructure, the lien attaching primarily to the latter, and to the former only as it is embraced in a common ownership with the building, has existed in California from an early date. . . . Any other interpretation would necessarily render unconstitutional those sections of the code purporting to relieve the owner from liability upon filing and posting a notice of nonresponsibility.

*Id.* at 642, 20 P.2d at 951. The *English* court then considered the owner's contention that because the building is a more or less permanent structure attached to the land, the building should be held to be part of the land with the result that no lien could attach to the building. The court said:

It is true that as between the landlord and the tenant it was agreed that the building when erected should become part of the realty, but that agreement could not affect the lien given by the Constitution to the mechanics. It is our opinion, when a lease provides that the lessee may construct permanent structures on the leased premises, which structures at the termination of the lease shall become the property of the lessor, that it must be held by reason of the constitutional and statutory provisions above discussed that as far as mechanics are concerned the structure does not become a fixture until all mechanic lien claimants are paid.

*Id.* at 642-43, 20 P.2d at 951. The *English* court refused, however, to follow other jurisdictions that deem the lessee to be a statutory agent of the owner when the lease contemplates the construction of a building that will enhance the value of the fee. The court said that in view of the nonresponsibility statute it did not feel justified in holding that the lien attached to the land as well as to the building. *Id.* at 643, 20 P.2d at 951. The court then stated:

We are of the opinion that, at least where the building of the improvement is optional with the lessee, the posting and filing of the notice of nonresponsibility by the lessor relieved the land from the lien. . . . It is true that to remove the building will interfere, temporarily, with the owners' right of possession, but the owner must be deemed to have consented to this interference by entering into the lease knowing such a building would probably be constructed on the leased premises.

*Id.* at 643-44, 20 P.2d at 951. The supreme court then ordered the trial court to grant a lien upon the Auditorium building "down to the surface of the ground." *Id.* at 644, 20 P.2d at 951.

<sup>55</sup> A property owner may, however, become personally liable to a claimant if the owner fails to withhold funds he owes the contractor after the claimant has filed a valid stop notice. See note 158 *infra*. In this connection it should be remembered that the stop notice actually is a remedy distinct from the lien remedy, even though both remedies are contained in the same chapter of the Code of Civil Procedure. See text accompanying note 12 *supra*.

<sup>56</sup> CAL. CODE CIV. PROC. §§ 1182(c), 1183.1(b); *McClain v. Hutton*, 131 Cal. 132, 61 Pac. 273, modified on other grounds, 131 Cal. 132, 63 Pac. 622 (1900); *Beard v. Lancaster Midway Oil Co.*, 72 Cal. App. 148, 236 Pac. 970 (1925).

An owner is not personally liable to subcontractors, laborers, and materialmen with whom he has no contractual privity,<sup>57</sup> and a contractor is not personally liable to laborers or materialmen with whom he has no contractual privity.<sup>58</sup> The mechanics' lien laws, however, do not restrict personal liability.<sup>59</sup>

Personal liability and lien liability tend to merge when dealing with the contractor and the owner. The making and performance of the building contract between these two parties creates both personal and lien liability. The contractor is, therefore, limited in his recovery on the lien to the amount due him under the terms of the building contract.<sup>60</sup> The contractor must deduct from his claim the amounts that other parties have claimed by lien for work and materials furnished to the contractor pursuant to his contract with the owner.<sup>61</sup> If a claim of lien is filed for work done or materials furnished to the contractor, then the contractor is obligated to defend the action at his own expense. During the pendency of such an action, the owner may *withhold* the amount of the claim from the amount due to the contractor; if judgment is rendered against the owner or his property, the owner may *deduct* the amount of the claim from the amount due to the contractor.<sup>62</sup> If the judgment exceeds the amount due from the owner to the contractor, or if the owner has settled in full with the contractor, then the owner is entitled to recover back from the contractor the amount the owner paid in excess of the contract price.<sup>63</sup>

## 2. Lien Liability

A claimant, other than the contractor, asserting a lien against the owner's property is not limited in the amount of his claim to the contract price of the building contract between the owner and his contractor.<sup>64</sup> Rather, the amount of

<sup>57</sup> *Roberts v. Security Trust & Sav. Bank*, 196 Cal. 557, 238 Pac. 673 (1925); *Stockton Lumber Co. v. Schuler*, 155 Cal. 411, 101 Pac. 307 (1909).

<sup>58</sup> *Kruse v. Wilson*, 3 Cal. App. 91, 84 Pac. 442 (1906).

<sup>59</sup> CAL. CODE CIV. PROC. § 1200 reads: "Nothing contained in this chapter shall be construed to impair or affect the right of any person to whom any debt may be due . . . to recover said debt against the person liable therefor." In one respect, it might be said that creditors secured by mechanics' liens are preferred to creditors secured by other devices. Compare CAL. CODE CIV. PROC. § 1200, stating that the mechanics' lien claimant "need not state that his demand is not secured by a lien" in his affidavit to procure an attachment, with CAL. CODE CIV. PROC. § 537(1), providing that the plaintiff may attach the property of the defendant in a contract action if the contract is *not* secured by any lien upon real property.

<sup>60</sup> CAL. CODE CIV. PROC. § 1186.1(a).

<sup>61</sup> *Ibid.*

<sup>62</sup> CAL. CODE CIV. PROC. § 1186.1(b).

<sup>63</sup> CAL. CODE CIV. PROC. § 1186.1(b). This section limits the owner's recovery back from the contractor to the amount "for which the contractor was originally the party liable." Thus, if the claimant is the materialman of a subcontractor, the owner apparently would not be able to recover back from the contractor even if the judgment against the owner exceeded the contract price. The risk of such "hidden" claimants is thus shifted from the contractor to the owner. Apparently, however, the section has not been construed in this manner by others. The principal argument of the contractors in support of CAL. CODE CIV. PROC. § 1193 was that the contractors often were subjected to double payment because of the unpaid claims of such "hidden" claimants. SENATE JUDICIARY COMM. FOR INTERIM 1957-1959, FIFTH PROGRESS REPORT TO THE CALIFORNIA LEGISLATURE 57, 93 (1959) [hereinafter cited as FIFTH PROGRESS REPORT].

<sup>64</sup> CAL. CODE CIV. PROC. § 1185.1(a). This is consistent with the theory that underlies direct lien statutes. See note 20 *supra*. The claimant's right to a lien is thought to arise out of his contract directly with the owner or with the owner's agent. Payments by the owner to his statutory agent do not diminish the owner's total liability because the owner is in effect paying himself. See Comment, 68 YALE L.J. 138, 145 (1958). Thus, where the contractor employs a

his claim is limited only by his own contract with the owner or his agent.<sup>65</sup> The claimant, other than the contractor, who has actual notice of the terms of the building contract may recover only for *labor or materials* embraced within the building contract, even though the contract does not limit the *amount* of his recovery.<sup>66</sup>

The direct lien can be harsh on the owner if he has no way in which to protect his property from multiple claims<sup>67</sup> after he has paid the contractor.<sup>68</sup> Subjecting the owner to total responsibility for the failure of the contractor to pay his obligations may be an unconstitutional deprivation of the right to contract.<sup>69</sup> To avoid this constitutional objection, the legislature has provided that the owner may protect his property from unlimited lien liability by filing, before work is commenced, (1) his building contract together with (2) a labor and material payment bond from the contractor.<sup>70</sup> When this is done, the court

subcontractor, the owner's total liability is not limited by the price of his contract with the contractor but is only limited by the price of the subcontractor's contracts with lien claimants who claim through the subcontractor. CAL. CODE CIV. PROC. § 1185.1(a). Compare the derivative lien statutes discussed in note 156 *infra*.

<sup>65</sup> The risk that the contractor will underbid the construction job is thereby shifted from the contractor and the other claimants to the owner. Theoretically, *i.e.*, apart from the problem of priorities, the mechanics' lien claimant can never lose—but the owner and, secondarily, the contractor can.

<sup>66</sup> CAL. CODE CIV. PROC. § 1185.1(a). If the owner records his building contract, the claimant is deemed to have actual notice of its terms for this purpose. CAL. CODE CIV. PROC. § 1185.1(b).

<sup>67</sup> See note 20 *supra*.

<sup>68</sup> In short, if the owner pays his contractor, but the contractor fails to pay other claimants, the owner may be forced to pay twice to free his property of liens. This is the so-called "double payment" problem. See generally FIFTH PROGRESS REPORT 17-119.

<sup>69</sup> See *Latson v. Nelson*, 2 Cal. Unrep. 199, 11 Pac. C.L.J. 589 (1883). In the leading case of *Roystone Co. v. Darling*, 171 Cal. 526, 539, 154 Pac. 15, 20 (1915), the supreme court made the following observation about the scheme before the court in *Latson v. Nelson*:

The amendment of 1880 to section 1183 [predecessor to CAL. CODE CIV. PROC. §§ 1181, 1182] purported to confer liens for work and material on buildings without any regard whatever to the contract between the owner and the contractor. It gave the owner no method of exercising his right to contract with the builder for improvements on his property, without practically assuming total responsibility for all failure of such builder to pay for the labor and material thereon. It provided no means whereby he could avoid liens placed upon the property for the value of such work and materials. The right of persons to contract in that manner respecting their property was, to that extent, taken away.

<sup>70</sup> CAL. CODE CIV. PROC. § 1185.1(c). The California Supreme Court in *Roystone Co. v. Darling*, 171 Cal. 526, 154 Pac. 15 (1915), held that the addition of the labor and material bond provision (the court called it "the important provision" of the scheme) rendered constitutional the present direct lien scheme. The court reasoned:

The law of 1911 here involved does not deprive the owner of the right to contract for the improvement of his property. It allows him to contract freely for such improvement and upon such terms as he may deem for his best interests. All it exacts from him, as a condition of such exemption from liability, and in order to make his contract effective, is that he shall provide a reasonable security for the constitutional lien given for labor and materials furnished his contractor. It is not an unreasonable burden. It is one which we think the people have the power to impose, and which we believe to be within the scope of the constitutional mandate in the section conferring such liens, and of the police power.

*Id.* at 540, 154 Pac. at 21. Consequently, the present direct lien scheme probably is constitutional only because it provides a method whereby the owner may exempt his property from unlimited liability. Yet one observer has noted:

For the past two to three decades, owners have not bothered to record their contracts (on private works). Few bonds have been recorded, and these only for jobs

"where it would be equitable so to do" must restrict the amount of recovery by lien claimants to the amount due from the owner to the contractor.<sup>71</sup> The bond must be in an amount not less than fifty per cent of the contract price and must enure to the benefit of those who perform labor or furnish materials.

#### D. Priorities

##### 1. Relation Back to Time of Commencement Rule

All mechanics' liens are deemed to attach to the property at the time work is commenced<sup>72</sup> on the "entire structure or scheme of improvement as a whole."<sup>73</sup> Therefore, any particular claim of lien does *not*, for priority purposes, date from the time when the claimant did his work<sup>74</sup> or from the time when he recorded his claim of lien. Rather, all mechanics' liens arising out of the same work of improvement are on a parity with each other regardless of the time when the respective claimants performed labor or furnished materials.<sup>75</sup> Such claimants are entitled to share pro rata in the proceeds upon a lien foreclosure.<sup>76</sup> Moreover, mechanics' liens are preferred to "any lien, mortgage, deed of trust, or other encumbrance" of which the lien claimant had no notice and which was unrecorded at the time the work of improvement was commenced.<sup>77</sup> The lien claimant in effect must have actual notice of a prior but unrecorded lien or encumbrance.<sup>78</sup>

Work is "commenced" when there "is some work and labor on the ground, the effects of which are apparent—easily seen by everybody; such as beginning to dig the foundation, or work of like description, which everyone can readily see and recognize as the commencement of a building."<sup>79</sup> Application of this "visible to the eye" test can be difficult. For example, suppose claimant *A* delivers materials but then removes them because he is afraid of theft. A money lender then inspects the jobsite, finds no visible evidence of construction, makes a loan, and records his construction money deed of trust. Claimant *B* delivers materials after the deed of trust has been recorded. What are the relative priorities of the

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involving relatively large sums of money. It seems that owners have forgotten their constitutional rights regarding contracts which was so important to the court in the *Roystone Co. v. Darling* case.

State Bar Report, F, 6.

<sup>71</sup> CAL. CODE CIV. PROC. § 1185.1(c); see CAL. CODE CIV. PROC. § 1185.1(d).

<sup>72</sup> CAL. CODE CIV. PROC. § 1181.1. But see discussion of § 1184.1 liens in part I, F, following note 128 *infra*.

<sup>73</sup> This is the way in which "work of improvement" is defined for purposes of mechanics' lien law. CAL. CODE CIV. PROC. § 1182(b).

<sup>74</sup> Prior to a change of law in 1931, the lien dated from the time the claimant did his work, if he did such work pursuant to a separate contract as opposed to a general contract. See 5 So. CAL. L. REV. 312 (1932).

<sup>75</sup> OGDEN, CALIFORNIA REAL PROPERTY § 16.31 (1956); see *Stimson Mill Co. v. Nolan*, 5 Cal. App. 754, 91 Pac. 262 (1907).

<sup>76</sup> *Ibid*.

<sup>77</sup> CAL. CODE CIV. PROC. § 1188.1.

<sup>78</sup> In *J. & W.C. Shull v. Brooke*, 107 Cal. App. 88, 289 Pac. 885 (1930), the court held that knowledge of a materialman that the owner had borrowed construction funds was not sufficient notice of the unrecorded deed of trust for priority purposes. The court did not, however, deny the possibility that constructive notice other than by recordation might be sufficient notice. In *Keeling Collection Agency v. Penziner*, 123 Cal. App. 296, 11 P.2d 24 (1932), where the lien claimant had, among other things, discussed the loan with the lender, the court held that he had sufficient notice.

<sup>79</sup> *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 637, 20 P.2d 946, 948 (1933), quoting PHILLIPS, MECHANICS' LIENS 387 (3d ed. 1893).

lender, claimant *A*, and claimant *B*?<sup>80</sup> Case law provides no answer to this and similar problems. The best guideline the courts have been able to provide is that the question of time of commencement is a question of fact in each case.<sup>81</sup>

## 2. Purchase Money Encumbrances

Section 2898 of the California Civil Code states: "A mortgage or deed of trust given for the price of real property at the time of its conveyance, has priority over all other liens created against the purchaser, subject to the operation of the recording laws." There is no priority problem, of course, if a mechanics' lien is recorded prior to the purchase transaction or, conversely, if the purchase money deed of trust is recorded prior to the time when work on the improvement is commenced. If, however, work has commenced but no claims of lien have been recorded at the time of the purchase transaction, a problem of the relative priority of mechanics' liens and purchase money encumbrances is present. In *Hayward Lumber & Inv. Co. v. Starley*,<sup>82</sup> materials were furnished to the holder of an option to purchase the land. Since the purchase transaction had not been completed, the court reasoned that the option holder was not yet the owner and could not therefore create any mechanics' liens against the property. Upon the completion of the purchase transaction, the deed to the buyer and the purchase money deed of trust back to the seller took effect simultaneously—so simultaneously, the court reasoned, that the mechanics' lien could not squeeze in ahead of the purchase money deed of trust. It should be noted, however, that the materialman in this case knew the state of the title, whereas the seller did not know that the materials had been furnished. It has been suggested that the mechanics' lien should be prior to the purchase money encumbrance where the seller has actual or constructive notice that work on the improvement has been commenced.<sup>83</sup>

Even where the purchase money encumbrance is recorded before work is commenced, the mechanics' lien may be prior if the buyer and seller are joint venturers in the construction project.<sup>84</sup> One observer has noted the following practices with respect to this problem:

[V]ery frequently there will be a secret or private understanding by which the purchase money encumbrance is not the true agreement between the maker [the buyer] and the receiver [the seller] of such encumbrance. A trust deed, apparently securing an obligation of a fixed sum, will be executed and delivered and placed of record; but the actual agreement will be one of a sharing of profits. . . .<sup>85</sup>

The effect of this practice, if undiscovered, would be to give priority to the recorded purchase money deed of trust over mechanics' liens. If the venture fails, the seller could foreclose his prior trust deed and share the proceeds with the

<sup>80</sup> See State Bar Report, H-1, 8.

<sup>81</sup> See, e.g., *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 20 P.2d 946 (1933). It has been suggested that the recent case of *Nolte v. Smith*, 189 Cal. App.2d 140, 11 Cal. Rptr. 261 (1961), further has complicated the question because it in effect departed from the "visible to the eye" test since the court did not even consider the visibility of certain underground pipe markers. State Bar Report, H-1, 8. It would appear, however, that the visibility of the pipe markers was not in issue in *Nolte v. Smith* since there was no question of the priority of liens.

<sup>82</sup> 124 Cal. App. 283, 12 P.2d 66 (1932).

<sup>83</sup> State Bar Report, H-1, 2. See *Avery v. Clark*, 87 Cal. 619, 25 Pac. 919 (1890) (seller had notice of commencement of work of improvement). It is unclear whether the seller could protect his priority by filing a notice of nonresponsibility. See State Bar Report, H-1, 2.

<sup>84</sup> *City Lumber Co. v. Brown*, 46 Cal. App. 603, 189 Pac. 830 (1920).

<sup>85</sup> State Bar Report, H-2, 2.

buyer. Since the property probably would be overvalued initially, the mechanics' lien claimants would be left with a worthless security.

### 3. Construction Money Encumbrances

#### a. Future Advances<sup>86</sup>

In the usual case, secured building loans are made under an agreement that the lender will disburse loan proceeds as construction work progresses. The construction loan is secured by a deed of trust that is recorded prior to the commencement of work on the improvement. The relative priority of these future advances and mechanics' liens may be stated simply. If the future advances are obligatory, *i.e.*, the lender has no choice but to advance the loan proceeds when the conditions of the loan contract are met, then the lender's recorded trust deed is prior to mechanics' liens.<sup>87</sup> Moreover, a construction money deed of trust that is prior to a mechanics' lien as to obligatory advances is also prior as to optional advances that are used to pay recorded claims of lien or costs of improvement.<sup>88</sup> The priority of the deed of trust as to these optional advances cannot, however, exceed the amount of the original obligatory commitment of the lender.<sup>89</sup>

Even when the lender is given the choice of withholding future advances by the terms of the loan agreement, each such advance is subordinate only to intervening mechanics' liens of which the lender had *actual* notice.<sup>90</sup> It is settled that constructive notice afforded by recordation is not sufficient to subordinate voluntary advances.<sup>91</sup> Nevertheless, the lender's actual knowledge that work is in progress and that labor and materials have been furnished may be sufficient for this purpose.<sup>92</sup>

#### b. Undisbursed Construction Loan Proceeds

When the work of improvement is completed, the lender still may have undisbursed construction loan proceeds, e.g., the final progress payment. There may be unpaid lien claimants who have worthless liens because the property is encumbered to its full value, e.g., by a prior purchase money encumbrance and a prior construction money encumbrance. The payment of the unexpended loan proceeds either to the owner or to the lender would cause either the owner or the lender to be unjustly enriched at the expense of the lien claimants: if the proceeds are paid to the owner, he will have the benefit of the improvements; if the proceeds are paid to the lender, he will have the benefit of the increase in the value of his security interest (the owner's property).

In such a case, three separate remedies may be available to the unpaid lien claimant: (1) the undisbursed proceeds may constitute a trust fund for the benefit of the unpaid claimants;<sup>93</sup> (2) the unpaid claimant may be entitled to

<sup>86</sup> The problem of future advances is common both to purchase money encumbrances and to construction money encumbrances. The present discussion is limited to construction money encumbrances, however, since mechanics' lien priority problems arise most often with respect to installment construction loans.

<sup>87</sup> *Smith v. Anglo-California Trust Co.*, 205 Cal. 496, 271 Pac. 898 (1928).

<sup>88</sup> CAL. CODE CIV. PROC. § 1188.1; CALIFORNIA LAND SECURITY AND DEVELOPMENT § 30.27 (Cont. Ed. Bar 1960).

<sup>89</sup> *Ibid.*

<sup>90</sup> *Imhoff v. Title Ins. & Trust Co.*, 113 Cal. App.2d 139, 247 P.2d 851 (1952).

<sup>91</sup> *Tapia v. Demartini*, 77 Cal. 383, 19 Pac. 641 (1888).

<sup>92</sup> See *W. P. Fuller & Co. v. McClure*, 48 Cal. App. 185, 191 Pac. 1027 (1920); *cf. Atkinson v. Foote*, 44 Cal. App. 149, 184 Pac. 901 (1919).

<sup>93</sup> *Whiting-Meade Co. v. West Coast Bond & Mortgage Co.*, 66 Cal. App.2d 460, 152 Pac. 629 (1944).

an equitable lien against the undisbursed funds;<sup>94</sup> and (3) the lien claimant may file a statutory bonded stop notice with the lender and thereby effect an equitable garnishment of the funds.<sup>95</sup>

#### 4. Subordination of Mechanics' Liens: The Priority Bond

A money lender ordinarily will not make a construction loan unless he receives a first deed of trust.<sup>96</sup> The lender will therefore require the holder of a prior purchase money encumbrance to execute an agreement subordinating his purchase money encumbrance to the construction money deed of trust.<sup>97</sup>

If the concededly prior purchase money trust deed is thus subordinated to the construction money trust deed, a "circuitry of lien" problem may arise with respect to the relative priorities of the two trust deeds and mechanics' liens.<sup>98</sup> The problem does arise when the mechanics' lien is prior to the construction money trust deed. To illustrate: (1) the mechanics' lien is prior to the construction money trust deed; (2) the construction money trust deed is prior to the purchase money trust deed; and (3) the purchase money trust deed is prior to the mechanics' lien. Ogden concludes: "This circuitry has been resolved in many ways, none entirely satisfactory . . . Each case, therefore, will be decided on its own facts, and no general rule of priority can be stated."<sup>99</sup>

Probably in partial response to the circuitry of lien problem, the legislature enacted section 1188.2 in 1951. This section provides that a lender who holds a trust deed that is inferior to mechanics' liens may procure and file a labor and material payment bond.<sup>100</sup> Upon filing the bond, the trust deed becomes "prior and paramount to the liens of all persons arising out of such work of improvement for work done or materials furnished *subsequent* to the time such bond is filed."<sup>101</sup>

Filing the section 1188.2 bond by the holder of the construction money trust deed would cause the respective encumbrances in the above circuitry problem to rank in the following order of priority: (1) construction money trust deed; (2) purchase money trust deed; (3) mechanics' liens for work done and labor furnished *subsequent* to the posting of the 1188.2 bond. Still unresolved is the cir-

<sup>94</sup> *Smith v. Anglo-California Trust Co.*, 205 Cal. 496, 271 Pac. 898 (1928); *Hayward Lumber & Inv. Co. v. Coast Fed. Sav. & Loan Ass'n*, 47 Cal. App. 211, 117 P.2d 682 (1941).

<sup>95</sup> CAL. CODE CIV. PROC. § 1190.1(h).

<sup>96</sup> One observer has noted:

[N]o lender of money will ordinarily permit the trust deed or mortgage securing his building loan to be junior to any purchase money encumbrance and, therefore, in practically every case where there is an existing purchase money encumbrance against the property about to be improved, the lender will make no loan unless there is signed and recorded subordination agreements by which the holders of purchase money encumbrances given for the purchase price of the property subordinate the lien of such purchase money encumbrance to the trust deed about to be executed, delivered and recorded; otherwise no building loan will be made.

State Bar Report, H-2, 2.

<sup>97</sup> The holder of the purchase money encumbrance will be willing to subordinate his encumbrance because the value of his security (the owner's property) will be increased pro tanto (theoretically) by the construction project.

<sup>98</sup> OGDEN, CALIFORNIA REAL PROPERTY § 17.30 (1956).

<sup>99</sup> *Ibid.*

<sup>100</sup> The bond must be in an amount not less than seventy-five per cent of the trust deed, must refer to the trust deed, and must inure to the benefit of all mechanics' lien claimants. CAL. CODE CIV. PROC. § 1188.2.

<sup>101</sup> CAL. CODE CIV. PROC. § 1188.2. (Emphasis added.) Compare CAL. CODE CIV. PROC. § 1189.1(b), which provides that upon filing the § 1189.1(a) bond *all* § 1184.1 liens become junior to the trust deed.

cuity problem with respect to the two trust deeds and the mechanics' liens for work done and labor furnished *prior* to the posting of the 1188.2 bond.

*E. The Interaction of the Modern Construction Industry and the Basic Scheme: Tract Development*<sup>102</sup>

The basic scheme of the present statutes appears to be predicated upon the assumption that improvements to real property will be undertaken by single owners upon single parcels of land.<sup>103</sup> Much of the construction activity was done in this manner when the present basic scheme was enacted in 1911, and in that context it is possible that there was some logic to the "work of improvement" concept. Today, however, a considerable amount of the improvement to real property is undertaken by speculative builders in the form of tract developments. These changing conditions in the construction industry have caused certain difficulties in applying the 1911 system of mechanics' liens. The legislature, by modifying the 1911 system, has attempted to meet two contemporary problems: (1) that of supplying materials to the tract development, and (2) that of determining commencement and completion of work upon individual units within a tract.

*1. Supplying Materials to the Tract Development*

As pointed out above,<sup>104</sup> the materialman seeking a lien must prove (1) that the materials he supplied actually were used or consumed in the particular work of improvement, and (2) that the materials were furnished "to be used or consumed in" that particular work of improvement. These two requirements are consistent with the "contribution" theory—the materialman must be able to follow his contribution of materials into the thing in which they were incorporated. The requirements are, however, extremely burdensome when applied to modern tract development. Ordinarily, the speculative builder buys his materials in bulk quantities to obtain a better price. The materials then are delivered to a central receiving point for the entire tract and are distributed indiscriminately to the individual residential units.

Consequently, in tract developments, the legislature has in effect abolished the first requirement that the materialman follow his materials to a particular residential unit in the tract. Section 1194.1 provides for the situations in which the materialman can show either (1) that the tract is owned or reputed to be owned by the same person, or (2) that he was employed by the same person (speculative builder, segregated contractor, or subcontractor). In either event, if the materialman was employed to supply materials under a "lump sum" contract that did not segregate the materials for each residential unit, then the materialman is permitted to apportion his claim among the individual units.<sup>105</sup> In addition, where the materialman supplies material to a single structure on separately owned parcels of land, the materialman is not required to apportion the materials for each such parcel.<sup>106</sup>

<sup>102</sup> See State Bar Report, A-5, 3, 4, for an excellent presentation of the problems in this area.

<sup>103</sup> State Bar Report, E-4.

<sup>104</sup> See note 42 *supra* and accompanying text.

<sup>105</sup> CAL. CODE CIV. PROC. § 1194.1(a). The materialman must of course base his apportionment upon the proportionate amount of materials furnished to individual units. Moreover, as against other lien claimants, the materialman is limited by the amount he designates to any particular unit.

<sup>106</sup> The court may, however, where it is equitable to do so, distribute the lien equitably as between the several parcels. CAL. CODE CIV. PROC. § 1194.1(b).

Section 1195.1 specifically abolishes the second requirement of the "contribution" theory by providing that

materials delivered to or upon any portion of . . . [the tract development] and ultimately used or consumed in one of such separate residential units shall, for all purposes of this chapter, be deemed to have been furnished *to be used or consumed in the separate residential unit in which the same shall have been actually used or consumed.*<sup>107</sup>

To avoid any doubt that sections 1194.1 and 1195.1 are to be read together to effect the abolition of the two requirements of the "contribution" theory, section 1195.1 further provides: "if the lien claimant [materialman] is unable to segregate the amounts used on or consumed in such separate [residential] units he shall be entitled to all the benefits of Section 1194.1 of this code."

## 2. Commencement and Completion of Separate Residential Units

Speculative builders may wish to sell each house in the tract development as soon as it is completed. "Work of improvement," however, is defined in section 1182(b) to mean the "scheme of improvement as a whole," or the tract development as a whole. There is a distinct possibility, therefore, that mechanics' liens arising from the entire tract development later may be asserted against any individual residential unit. Section 1195.1 alleviates this possibility by providing that, for purposes of determining the time within which claims of lien can be filed, each residential unit will be considered to be a separate work of improvement. This permits the speculative builder to file separate notices of completion for each unit, so that claims of lien to be valid must be filed against each unit within sixty days.<sup>108</sup> The speculative builder then may conveniently sell the individual unit.<sup>109</sup>

Although section 1195.1 apparently is intended to apply to completion problems,<sup>110</sup> its wording<sup>111</sup> has caused some speculation that the section also applies to commencement.<sup>112</sup> The question of the conflicting interpretations of section

<sup>107</sup> (Emphasis added.)

<sup>108</sup> CAL. CODE CIV. PROC. § 1193.1(a). Note that § 1195.1 does not apply to § 1184.1 liens.

<sup>109</sup> The title insurance company, by using a sixty day escrow, can safely write a policy that will insure against the assertion of mechanics' liens against the particular residential unit. Upon the issuance of the policy, the purchaser of the unit will be able to obtain purchase money financing.

The standard title insurance policy does not include mechanics' liens within its protection because potential claims of lien are deemed to be discoverable by an examination of the property. See CALIFORNIA LAND SECURITY AND DEVELOPMENT §§ 7.18, 30.32 (Cont. Ed. Bar 1960).

<sup>110</sup> State Bar Report, H-2, 11-13.

<sup>111</sup> CAL. CODE CIV. PROC. § 1195.1 reads:

If a work of improvement consists in the construction of two or more separate residential units, each such unit shall be considered a separate "work of improvement" or "improvement," and the time for filing claims of lien against each such residential unit as provided in this chapter shall commence to run upon the completion of each such residential unit.

<sup>112</sup> State Bar Report, H-1, 5. One author has stated the argument as follows:

If each work of constructing a residential unit is regarded as a "separate work of improvement" in accordance with the statutory definition, priority problems from the lender's viewpoint are largely solved. It is then only necessary to be certain that each deed of trust financing the improvements upon a particular lot is recorded before work starts on such lot; liens for work done on such lot would relate back only to the commencement of work thereon and hence would be inferior to the deed of trust . . . . But some doubt as to this interpretation is indicated by the fact that the definition in the statute is followed by the word "and," with the rest of the sentence dealing only with the time for filing claims of lien, thus suggesting the possibility that the definition was intended to make each residential structure a separate work of improvement solely for completion purposes.

1195.1 has been described as one of the "darlings" of the land law scholars.<sup>113</sup> The title companies have adopted a rule of practice that construction money encumbrances, to ensure their priority, should be recorded prior to the commencement of work on the first unit in a tract development.<sup>114</sup> Thus, to this extent, the question is moot. It has, however, been suggested that section 1195.1 be amended so that it clearly applies only to completion and not to commencement.<sup>115</sup>

A related problem concerns the subdivision project that involves a single general contract but is completed in several units that are separately financed.<sup>116</sup> For example, suppose a speculative builder buys a large parcel of land with the objective of subdividing it. He proposes to build in separate tracts; one tract will contain two bedroom residential units and the other will contain three bedroom residential units. He obtains the necessary financing from lender *A* for the two bedroom project and commences building. Soon thereafter he interests lender *B* in the three bedroom project. Since the work on both tracts is being done under one contract, it is possible that both tracts together constitute a single "scheme of improvement as a whole" so that both are one improvement.<sup>117</sup> Priority then would be determined by the date that work was begun on the two bedroom tract and lender *B*'s encumbrance would be subsequent to all mechanics' liens.<sup>118</sup> Lender *B*, if he is prudent, will require an ATA title insurance policy or a standard title insurance policy with a lien-free endorsement.<sup>119</sup> One attorney has suggested:

If the title company insists that the requisite period must elapse after the recordation of a proper notice of completion respecting . . . [the two bedroom project] . . . , or that a bond under C.C.P. § 1188.2 be supplied as a condition to the issuance of its policy, it will probably find the lender-customer taking his business to another, more careless title insurer who is willing to take the risk involved.<sup>120</sup>

The same attorney suggests that the problem would be eased or eliminated if the lien priority rule were that commencement of each house in a subdivision is com-

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<sup>113</sup> State Bar Report, H-1, 5.

<sup>114</sup> *Ibid.*

<sup>115</sup> State Bar Report, H-1, 5-5(a).

<sup>116</sup> State Bar Report, H-1, 6.

<sup>117</sup> CAL. CODE CIV. PROC. § 1182(b). This assumes that CAL. CODE CIV. PROC. § 1195.1 applies only to completion and not to commencement. See notes 110-15 *supra* and accompanying text.

<sup>118</sup> CAL. CODE CIV. PROC. § 1188.1.

<sup>119</sup> State Bar Report, H-1, 7; see CALIFORNIA LAND SECURITY AND DEVELOPMENT §§ 7.18, 30.32 (Cont. Ed. Bar 1960).

<sup>120</sup> State Bar Report, H-1, 7. The implication that the speculative builder will do everything in his power to avoid having to pay the premium on a § 1188.2 bond is, of course, significant. Unless the speculative builder is responsible for protecting the property from mechanics' liens after the project is completed, he is unconcerned with potential lien claims since they would be asserted against property now owned by the purchasers of the individual residential units. For this reason, the proposal of Mr. Behymer, set forth in notes 210-13 *infra* and accompanying text, has particular merit. Mr. Behymer's proposal would, in effect, require the lenders to police the mandatory bond requirement for the protection of individual owners and lien claimants. Although CAL. CODE CIV. PROC. § 1188.2 requires only that a bond meeting its requirements be filed, it would seem desirable to require that the lender procure and file a bond which meets the requirements of CAL. CODE CIV. PROC. § 1185.1(c) and thereby protect the individual owner (by limiting his lien liability to the contract price) as well as the lien claimant.

mencement only of that house.<sup>121</sup> He then suggests that legislation be considered that would measure the commencement of separately financed units of a subdivision from the commencement of the first house in that unit only.<sup>122</sup>

It seems fair to observe that the basic statutory scheme for mechanics' liens was not designed to meet the problems of modern tract development. Moreover, the legislative attempts to remold the basic scheme in piecemeal fashion to meet particular problems often has created almost as many new problems.

#### *F. Site Improvements: The Section 1184.1 Lien*

The present lien system is embodied principally in section 1181.<sup>123</sup> This lien is predicated upon a direct contribution to a "building, structure, or work of improvement," on the theory that a person should be permitted to follow his contribution into the thing in which it is incorporated. The section 1181 lien contemplates a structure above the ground,<sup>124</sup> and does not attach to the land where no lien is acquired on the structure.<sup>125</sup> It is apparent that this does not comprehend lien protection for those who contribute goods and services to improvements that do not result in a "superstructure."<sup>126</sup> In addition, the basic scheme does not seem to meet the problem of off-site improvements, such as streets, curbs, and gutters. A lien would attach, if it attached at all,<sup>127</sup> to the off-site improvements themselves and not to the lot or tract of the owner who caused the improvements to be made. Since owners who caused such improvements to be made often dedicate them to governmental units, difficult problems could arise if only the off-site improvements were subject to mechanics' liens.<sup>128</sup>

The problems of nonstructural and off-site improvements are covered by a separate lien scheme contained principally in section 1184.1.<sup>129</sup> Section 1184.1 provides:

<sup>121</sup> State Bar Report, H-1, 7.

<sup>122</sup> State Bar Report, H-1, 7. The author there suggests that the following questions would be occasioned by such proposed legislation:

(1) What are "separate units" within the meaning of the section? (2) For the rule to be operative, when and in what manner must the subdivider indicate his intention to proceed with the project in separate units? (3) Can a unit be "separately financed" within the meaning of the section if the *same lender* makes the loans for several or all of the units?

<sup>123</sup> CAL. CODE CIV. PROC. § 1181.

<sup>124</sup> See *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 644, 20 P.2d 946, 951 (1933), where the court granted the lien upon the auditorium building "down to the surface of the ground."

<sup>125</sup> OGDEN, CALIFORNIA REAL PROPERTY §16.8 (1956).

<sup>126</sup> The court in *English v. Olympic Auditorium, Inc.*, *supra* note 124, continuously referred to the distinction between land and superstructure, which distinction the court said had existed in California from an early date. *Id.* at 642, 20 P.2d at 950-51.

<sup>127</sup> The lien might not attach if the off-site improvements were made but no improvements were made on the owner's property, for no work of improvement would have been commenced. See CAL. CODE CIV. PROC. §§ 1181, 1182(a).

<sup>128</sup> Traditionally, public property has been exempted from mechanics' liens. See 32 CAL. JUR. 2D *Mechanics' Liens* § 25 (1956).

<sup>129</sup> It might appear that the legislature has attempted to meet these problems by amending § 1181 itself. The original counterpart of § 1181 provided for a lien only upon buildings and wharves, but the present § 1181 provides for a lien upon buildings, structures, and works of improvement. "Work of improvement" then is broadly defined to include "the seeding, sodding, or planting of any lot or tract of land for landscaping purposes, the filling, leveling, or grading of any lot or tract of land, the demolition of buildings, and the removal of buildings." CAL. CODE CIV. PROC. § 1182(a). Section 1183.1 then restricts the lien upon the land as

Any person who, at the instance or request of the owner (or any person acting by his authority or under him as contractor or otherwise) of any lot or tract of land, [1] grades, fills in, or otherwise improves [a] the [lot or tract of land] . . . , or [b] the street, highway, or sidewalk in front of or adjoining the [lot or tract of land] . . . , or [2] constructs or installs sewers or other public utilities therein, or [3] constructs any areas, or vaults, or cellars, or rooms, under said sidewalks, or [4] makes any improvements in connection therewith, has a *lien upon said lot or tract of land* for his work done and materials furnished.<sup>130</sup>

The land is the subject of the section 1184.1 lien;<sup>131</sup> it seems clear that 1184.1 does not contemplate a structure<sup>132</sup> but rather the improvement of the lot itself. Moreover, it seems clear that section 1184.1 applies to off-site improvements, because the section provides for a lien against the lot or tract for improvements "in front of or adjoining" the lot or tract.<sup>133</sup>

There are special rules of priority for section 1184.1 liens.<sup>134</sup> Beginning work on an 1184.1 improvement does not constitute commencement of work on a structural improvement if the two improvements are made pursuant to separate contracts.<sup>135</sup> For example, suppose a speculative builder hires a contractor to make site improvements financed by lender *A*. The speculative builder now attempts to obtain financing for residential units from lender *B*. If the site improvements were made pursuant to a separate contract, then lender *B* safely can make the loan; his construction money trust deed will be prior to mechanics' liens arising from the erection of the residential units since those liens will not relate back to the commencement of the site improvements.<sup>136</sup> Suppose, however, that the contractor did not make the site improvements pursuant to a contract separate from the contract for the erection of the residential units. In such a case, all mechanics' liens would relate back to the date of the commencement of the site improvements.

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opposed to the structure by providing that the § 1181 lien will attach only to "the land upon which any building, *improvement*, well or structure is constructed, together with a convenient space about the same, or so much as may be required for the convenient use and occupation thereof." CAL. CODE CIV. PROC. § 1183.1. (Emphasis added.) Since the word "improvement" means buildings and the like (structures), *Warren v. Hopkins*, 110 Cal. 506, 42 Pac. 986 (1895), whether "thereof" refers to the structures or to the land would appear to be immaterial. Even if "thereof" refers to the land, the provision for land itself appears to be predicated upon the existence of a structure. Thus, although it is arguable that the legislature has provided for the off-site problem with the "convenient use and occupation" provision, it appears that even this provision is predicated upon a structure.

<sup>130</sup> (Emphasis added.) Both the principles of statutory agency, CAL. CODE CIV. PROC. § 1182(c), and statutory estoppel, CAL. CODE CIV. PROC. § 1183.1(b), appear to apply to § 1184.1 liens.

<sup>131</sup> "[N]o doubt the lien would extend to any improvements which were a part of the land." *OGDEN, CALIFORNIA REAL PROPERTY* § 16.12 (1956). See 32 CAL. JUR. 2D *Mechanics' Liens* § 32 (1956), where it is stated that § 1184.1 "does not contemplate a building, but an improvement of the lot itself or the adjacent street or highway." See also *Macomber v. Bigelow*, 126 Cal. 9, 58 Pac. 312 (1899). The word "improves" as used in the predecessor section to § 1184.1 refers to the improvement of the lot or parcel itself, whereas the word "improvement" as used in the predecessor section to § 1182(b) refers to improvements placed on the ground by way of buildings or the like. *Warren v. Hopkins*, 110 Cal. 506, 42 Pac. 986 (1895).

<sup>132</sup> See *Macomber v. Bigelow*, 126 Cal. 9, 58 Pac. 312 (1899); *Warren v. Hopkins*, 110 Cal. 506, 42 Pac. 986 (1895).

<sup>133</sup> CAL. CODE CIV. PROC. § 1184.1.

<sup>134</sup> CAL. CODE CIV. PROC. § 1189.1.

<sup>135</sup> CAL. CODE CIV. PROC. § 1189.1(a). Furthermore, CAL. CODE CIV. PROC. § 1193.1(a) creates a distinct completion date, and therefore separate time requirements for filing a § 1184.1 claim of lien. See *Richards v. Hillside Dev.*, 177 Cal. App. 2d 776, 2 Cal. Rptr. 693 (1960).

<sup>136</sup> See CAL. CODE CIV. PROC. § 1189.1(a).

Lender *B*'s construction money trust deed then would be junior to all mechanics' liens.<sup>137</sup>

Section 1184.1 liens are preferred to all encumbrances that attach subsequent to the commencement of 1184.1 improvements and to all encumbrances of which the lien claimant had no notice and which were unrecorded at the time the 1184.1 improvement was commenced.<sup>138</sup> This priority rule is exactly the same as the priority rule applicable to section 1181 liens.<sup>139</sup> In addition, however, section 1184.1 liens are prior to "any mortgage, deed of trust, or other encumbrance *recorded before the commencement of the [1184.1] work of improvement . . . which was given for the sole or primary purpose of financing such work of improvement.*"<sup>140</sup> This special priority rule provides that the lender who finances the site improvement is junior to mechanics' liens even though he records his construction money trust deed prior to the commencement of the site improvements. The lender who finances site improvements can become senior to mechanics' liens if

the loan proceeds are, in good faith, placed in the control of the lender under a binding agreement with the borrower to the effect [1] that such proceeds are to be applied to the payment of claims for labor performed or materials used or consumed in such work of improvement and [2] that no portion of such proceeds will be paid to the borrower in the absence of satisfactory evidence that all claims for such labor or materials have been paid or that the time for filing claims of lien arising out of such work of improvement has expired and no such claims have been filed.<sup>141</sup>

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<sup>137</sup> CAL. CODE CIV. PROC. § 1189.1(a) actually provides:

If the work of improvement of the character referred to in Section 1184.1 is provided for in a separate contract from any contract or agreement with respect to the erection of residential units or other structures upon said lot or tract of land, then the work of improvement of the character referred to in that section shall be deemed a separate work of improvement and the commencement thereof shall not constitute a commencement of the work of improvement consisting of the erection of any residential unit or other structure upon said lot or tract of land.

One observer states the problem in this way:

Furthermore, the confusion is worst confounded in the many cases where the speculative builder . . . employs an excavating and grading contractor to fill, level and grade the entire parcel of land . . . . This contract will not only, in many cases, embrace the work already mentioned, but also, in some of the smaller housing units, the foundation will consist of the flat concrete slab under the entire housing unit, in which will be embedded during the process of the work pipes installed by the plumbers . . . . Ofttimes the only money that the speculative builder puts into the project is the front money, sufficient to do the general tract improvement work, including possibly the foundations referred to; and sometimes in the same contract there will be embraced sidewalks, curbs and driveways.

State Bar Report, H-2, 10-11. It would seem at least arguable that laying such a foundation is the commencement of the erection of a structure. If so, then lender *B*'s construction money trust deed in the example in the text would be junior to all mechanics' liens.

<sup>138</sup> CAL. CODE CIV. PROC. § 1189.1(b).

<sup>139</sup> CAL. CODE CIV. PROC. § 1188.1; see part I, D, following note 71 *supra*.

<sup>140</sup> CAL. CODE CIV. PROC. § 1189.1(b). (Emphasis added.)

<sup>141</sup> CAL. CODE CIV. PROC. § 1189.1(b)(3). One author has made these remarks about this special provision:

There is at least a superficial resemblance between 1189.1(b) and the construction loan statutes of such states as New York. Under such statutes, it appears an encumbrance securing a building loan is given priority only if the proceeds thereof are held in a "trust fund" for the benefit of mechanics' lien claimants. If the loan contract complies with the law, the claims of laborers and materialmen attach to the fund and not to the property . . . . Since the California Constitution is held to give mechanics and materialmen a right against the property itself, which cannot be

As an alternative to the lender's control provision, the money lender may make his construction money trust deed senior to mechanics' liens by obtaining a priority bond.<sup>142</sup> But, as opposed to the priority bond provision applicable to section 1181 liens, when such a bond is filed the construction money trust deed is prior to *all* mechanics' liens, not only to those that attach subsequent to obtaining the bond.<sup>143</sup> The coexistence of the special priority rules applicable to section 1184.1 liens and the ordinary priority rules applicable to section 1181 liens apparently has caused considerable confusion.<sup>144</sup>

It seems clear that the coexistence of two distinct lien schemes creates confusion both as to priority and nonpriority rules. One attorney has thus commented about the section 1184.1 system: "The effect of this distinct lien system is to create a trap for the unwary. A statutory revision designed to introduce some measure of intellectual order to the chaos would eliminate this distinction as a needless appendage."<sup>145</sup>

### G. Stop Notices on Private Jobs

In comparison to the mechanics' lien, the stop notice is a very simple remedy. Nevertheless, perhaps to provide consistency to the law of real property security devices, the legislature has embodied almost the entire stop notice law in a single code section that is virtually incomprehensible.<sup>146</sup>

The stop notice is a lien, but, contrary to the mechanics' lien, it is a charge against the construction funds instead of against the real property. The stop notice is a remedy distinct from the mechanics' lien. The lien claimant does not waive

divested by legislation . . . , it is doubtful that a measure similar to those described would be constitutional in California if it purported to apply to all mechanics' liens. But if the 1184.1 lien is, as indicated, of purely statutory, not constitutional origin, there is no constitutional objection to 1189.1(b). In any case, measures favoring lien claimants are not likely to be held unconstitutional.

Norton, *The Nature, Scope and Priority of Mechanics' Liens in California* § 115, 1955 (unpublished monograph in Bank of America Law Library, San Francisco).

<sup>142</sup> CAL. CODE CIV. PROC. § 1189.1(b). The bond must be either a bond meeting the requirements of CAL. CODE CIV. PROC. § 1185.1(c) or a labor and material payment bond in an amount not less than fifty per cent of the face principal amount of the construction money trust deed.

<sup>143</sup> The bill enacting § 1189.1(b) was drafted by Mr. Melvin B. Ogden, Vice President and Chief Title Officer of the Title Insurance & Trust Company, and Mr. Glen Behymer of the Los Angeles Bar. State Bar Report, H-2, 15. The bill incorporates the same system as the system provided for 1181 liens by A.B. 2440, Cal. Leg., Reg. (Gen.) Sess. (1953); viz., the bill in effect requires the construction money lender to cause a labor and material payment bond to be obtained. See discussion of A.B. 2440 in text accompanying notes 210-13 *infra*.

<sup>144</sup> See State Bar Report, H-1, 3-4. One attorney has asked: "Why should the lender who finances only the off-site improvements have any greater burden in order to protect his position of priority?" *Id.* H-1, 4. The attorney then recommended that the § 1184.1 priority rules be amended to conform to the § 1181 priority rules. *Id.* H-1, 4(a). Whether this recommendation necessarily follows is open to considerable doubt.

<sup>145</sup> State Bar Report, E, 4-5.

<sup>146</sup> See CAL. CODE CIV. PROC. § 1190.1. Although § 1190.1 is a model of bad drafting, the subcommittee studying private stop notices recommended that it not be redrafted at this time because such redrafting was "not of sufficient importance to warrant action by the State Bar." State Bar Report, J-1, 1. The subcommittee justified this conclusion by pointing out that the stop notice has fallen into disuse in California practice. The subcommittee said: "[P]rivate stop notices have little or no place in present day building practices. . . . [T]he supplier, subcontractor or builder obtains quicker and more adequate relief from reliance upon the existing lien statutes." State Bar Report, J-1, 1. CAL. CODE CIV. PROC. §§ 1190.1, 1197.1 are summarized in appendix C.

his right to file a mechanics' lien when he gives a stop notice.<sup>147</sup> The stop notice may be given at any time after the claimant agrees to provide his labor or materials and before the expiration of the time within which claims of lien must be filed.<sup>148</sup> Any potential mechanics' lien claimant<sup>149</sup> except the contractor may give a stop notice to the owner or to any person who holds construction funds.<sup>150</sup> When a mandatory stop notice is filed, the holder of the funds must withhold out of the amount due to the contractor an amount sufficient to answer the claim of the one who gave the notice. Since the stop notice is a remedy designed to protect secondary improvers—those potential lien claimants other than the contractor—filing a labor and material payment bond obviates the necessity for the stop notice remedy. Accordingly, no duty to withhold is imposed upon the holder of construction funds if a proper bond is filed.<sup>151</sup>

In addition, if any party disputes the claim of the one who gives the stop notice, then he may file a release bond with the custodian of the construction funds.<sup>152</sup> This bond must be in a penal sum of one and one-quarter times the amount of the disputed claim.<sup>153</sup> Apparently, such a release bond may be filed regardless of who holds the funds, though it is not entirely clear because of the positioning and the wording of the subsection that provides for the release bond.<sup>154</sup> Upon the filing of such a bond, the withheld funds must be released forthwith.<sup>155</sup>

Since the stop notice is by definition limited to the amount due to the contractor, the problem of limiting the owner's liability is not present.<sup>156</sup> There is, however, a problem of liability as to when the person holding funds must respond to the stop notice. Whether the stop is mandatory or permissive in turn depends upon who holds the funds, *i.e.*, whether the owner holds the funds or whether a third party holds the funds.

### 1. Owner Holds the Funds

If a stop notice is properly<sup>157</sup> given to the owner, then the owner must withhold the amount of the claim from the amount he owes the contractor. If the

<sup>147</sup> *Diamond Match Co. v. Silberstein*, 165 Cal. 282, 166 Pac. 6 (1917).

<sup>148</sup> CAL. CODE CIV. PROC. § 1190.1(a).

<sup>149</sup> CAL. CODE CIV. PROC. § 1190.1(a) provides that any of the persons mentioned in §§ 1181 and 1184.1, except the contractor, may file a stop notice.

<sup>150</sup> CAL. CODE CIV. PROC. § 1190.1(h).

<sup>151</sup> CAL. CODE CIV. PROC. § 1190.1(c).

<sup>152</sup> CAL. CODE CIV. PROC. § 1190.1(c), (j). The bond must meet the requirements of CAL. CODE CIV. PROC. § 1185.1(c).

<sup>153</sup> CAL. CODE CIV. PROC. § 1190.1(i).

<sup>154</sup> *Ibid.*

<sup>155</sup> See CAL. CODE CIV. PROC. § 1190.1(i).

<sup>156</sup> CAL. CODE CIV. PROC. § 1190.1(c). The stop notice is based upon the same theory as that upon which the derivative lien statutes are based. As opposed to the direct lien statutes, see note 20 *supra*, the derivative lien claimant is said to possess his lien right against the owner's property only derivatively through the person with whom he contracts to provide labor or materials. See Comment, 68 YALE L.J. 138, 142-44 (1958). The claimant is limited in his recovery to the amount owing to the person with whom he contracted and is further limited by the amount due from the owner to the contractor. For example, in a derivative lien jurisdiction, suppose that a materialman to a subcontractor has a claim against the subcontractor for \$7,500. If the amount due from the contractor to the subcontractor is \$2,000, the materialman's lien will be limited to \$2,000, assuming that at least \$2,000 is due from the owner to the contractor. If, however, only \$1,000 is due from the owner to the contractor, then the materialman's lien will be limited to \$1,000. The lien claimant is thus limited to the amount due on the contract at each degree from the claimant to the owner. *Ibid.*

<sup>157</sup> CAL. CODE CIV. PROC. § 1190.1(a) provides, for example, that the stop notice may be given at any time prior to the expiration of the period within which claims of lien must be filed.

owner fails to withhold in accordance with the stop notice, he becomes personally liable to the stop notice claimant for the amount of the claim.<sup>158</sup> The owner is not required to withhold the claim amount if a labor and material bond that meets the requirements of section 1185.1 has been furnished and filed.<sup>159</sup> By filing the labor and material bond, the owner is able to ensure that the progress of his construction project will not be interrupted by the assertion of stop notices.

When the claimant files his stop notice after some, but not all, of the funds have been paid to the contractor and insufficient funds remain with which to pay in full the claimants, the owner must, of course, withhold the entire amount remaining. Because of the wording of section 1190.1(d), however, considerable confusion appears to exist with respect to this situation.<sup>160</sup> It has been suggested that the owner, after he has withheld the funds, may distribute them pro rata among the claimants.<sup>161</sup> However, section 1190.1(d) by its terms does not appear to give the owner power to distribute the withheld funds, but appears to apply only to the ultimate distribution of the withheld funds in court.

The possibility that one claimant can impede the progress of the entire job is probably the major objection to the stop notice remedy. Perhaps in response to this objection, the legislature in 1959 enacted a summary proceeding to determine the validity of the claim of the stop notice claimant.<sup>162</sup> If the contractor disputes the validity of the claim,<sup>163</sup> the parties may adjudicate their controversy by affidavit and counteraffidavit.<sup>164</sup> While the contractor may deliver the affidavit to the "department head, board, commission, or officer thereof," the section does not mention the private owner as one of the parties to whom the affidavit may be delivered.<sup>165</sup> Accordingly, it has been suggested that the summary proceeding may not be available on private construction jobs.<sup>166</sup> It could be interpreted to apply to private jobs, however, since one ground for invalidity of the claim is that the claimant is not one of the persons mentioned in sections 1181 or 1184.1.<sup>167</sup> In any event, it is clear that the summary proceeding is not available when the funds are held by a third party.<sup>168</sup>

The owner has reciprocal privileges under the stop notice provisions.<sup>169</sup> That is, if the owner makes a written demand upon a lien claimant to file a stop notice

<sup>158</sup> *Diamond Match Co. v. Silberstein*, 165 Cal. 282, 131 Pac. 874 (1913).

<sup>159</sup> CAL. CODE CIV. PROC. § 1190.1(c).

<sup>160</sup> CAL. CODE CIV. PROC. § 1190.1(d) reads:

In the event the moneys so withheld or required to be withheld shall be insufficient to pay in full the valid demands of all persons by whom such notices were given, the same shall be distributed among such persons in the same ratio that their respective claims bear to the aggregate of such valid demands. Such pro-rata distribution of said moneys shall be made among the persons entitled to share therein, without regard to the order of priority in which their respective notices may have been given or their respective actions, if any, commenced.

<sup>161</sup> See State Bar Report, J-1, 1; CALIFORNIA LAND SECURITY AND DEVELOPMENT § 30.38 (Cont. Ed. Bar 1960).

<sup>162</sup> See CAL. CODE CIV. PROC. § 1190.1(c) (paras. 3-10).

<sup>163</sup> There are four grounds upon which the contractor may dispute the validity of the claim: (1) The claim is not of the type referred to in § 1190.1. (2) The claimant is not one of the persons mentioned in § 1181 or § 1184.1. (3) The amount of the claim is excessive. (4) There is no basis in law for the claim. CAL. CODE CIV. PROC. § 1190.1(c) (para. 3).

<sup>164</sup> See CAL. CODE CIV. PROC. § 1190.1(c) (paras. 3-10).

<sup>165</sup> CAL. CODE CIV. PROC. § 1190.1(c) (para. 3).

<sup>166</sup> State Bar Report, J-1, 1 & app. A.

<sup>167</sup> See *ibid.*

<sup>168</sup> *Id.* at J-1, 3.

<sup>169</sup> See OGDEN, CALIFORNIA REAL PROPERTY § 16.17 (1956).

and the lien claimant refuses to give the notice, then the lien claimant thereby deprives himself of the right to file a mechanics' lien claim.<sup>170</sup>

## 2. *Third Party Holds the Funds*

If a third party holds the construction funds, giving a stop notice does not impose a duty upon the third party to withhold the funds, *i.e.*, the stop notice is permissive.<sup>171</sup> For example, in the ordinary construction job the construction money lender<sup>172</sup> will hold the funds and disburse them as the project progresses. If a lien claimant files a stop notice with this lender, the lender is under no duty to withhold the funds but may do so if he wishes.<sup>173</sup>

The lien claimant can, however, compel the third party to withhold if the claimant files a penal bond in a sum of one and one-fourth times the amount of his claim.<sup>174</sup> At this point it seems fair to observe that the reason the stop notice has fallen into disuse in California practice<sup>175</sup> is obvious. The great majority of private construction of any consequence is financed by someone other than the owner, and the construction funds are held by someone other than the owner. Giving an unbonded stop notice ordinarily will be a useless formality because the construction lender's primary interest is in seeing the project completed. The lien claimant is thus left with three choices: (1) he may procure a bond and cause his stop notice to become mandatory, (2) he may file a claim of lien, or (3) he may do both. When the property is fully encumbered so that the claim of lien would be valueless, the lien claimant may choose to procure the bond. If he does so, then it would appear that he has priority over all other creditors, including other mechanics' liens claimants, as to the amount withheld by the third party pursuant to the bonded stop notice.<sup>176</sup> There is, however, no clear answer to the question of the relative priority of stop notice and mechanics' lien claimants.<sup>177</sup>

## H. *Procedures for Perfecting the Liens*

A procedure chart presented in the State Bar Report<sup>178</sup> is contained in appendix B. It is believed that this is the best chart of its kind and may be of particular benefit to the practicing attorney who has a case dealing with mechanics' liens.<sup>179</sup>

<sup>170</sup> CAL. CODE CIV. PROC. § 1190.1(a) (last sentence).

<sup>171</sup> CAL. CODE CIV. PROC. § 1190.1(h).

<sup>172</sup> The person who holds the funds need not, of course, be the lender. He might also be an escrow holder or a builder's control agent. See notes 86-95 *supra* and accompanying text.

<sup>173</sup> At least CAL. CODE CIV. PROC. § 1190.1(h) in terms gives the lender the power to withhold. Suppose, for example, that the building loan contract between the owner and the lender provides that progress payments will be made regardless of outstanding stop notices. A stop notice is given to the lender. The lender withholds the amount of the claim in accordance with the stop notice. It is unclear whether a later advance of the loan proceeds to the owner will be deemed to be a permissive advance of the funds and to that extent cause the lender's construction money trust deed to become junior to mechanics' liens. See CAL. CODE CIV. PROC. § 1181.1. See also text accompanying notes 86-92 *supra*.

<sup>174</sup> CAL. CODE CIV. PROC. § 1190.1(h).

<sup>175</sup> See note 146 *supra*.

<sup>176</sup> It should also be noted that assignments of construction funds by the owner or the contractor, whether made before or after the claim is filed, do not have priority over the claim. CAL. CODE CIV. PROC. § 1190.1(h).

<sup>177</sup> See State Bar Report, J-2, 3, question 3.

<sup>178</sup> State Bar Report, C. The chart was prepared by Richard C. Dinkelspiel of the San Francisco Bar.

<sup>179</sup> In addition, reference to the procedures applicable to the present statutory scheme will be found in the footnotes to the proposed statutes contained in appendix A.

## *I. Public Construction Jobs*

### *1. California Government Jobs*

Stop notices are applicable to California government jobs.<sup>180</sup> The secondary improver is therefore given the right to give a stop notice to the "department head, board, commission, or officer thereof."<sup>181</sup> The right to give a stop notice is, however, somewhat broader with respect to public jobs than it is with respect to private jobs. For example, a lien claimant is entitled to give a stop notice for furnishing provender and provisions as well as labor and materials.<sup>182</sup>

Because of sovereign immunity, mechanics' liens are not applicable to government jobs.<sup>183</sup> Instead, the California Public Works Bond Act<sup>184</sup> provides that every person who is awarded a government construction contract in excess of \$1,000 must file a contractor's bond with the awarding officer or body.<sup>185</sup> The contractor's bond is similar to the section 1185.1(c) bond and must enure to the benefit of lien claimants.<sup>186</sup>

In addition, faithful performance bonds are required by statute from contractors on state public works<sup>187</sup> and on county building contracts.<sup>188</sup> It is also competent for cities and other local subdivisions to require faithful performance bonds.<sup>189</sup>

### *2. Federal Government Jobs*

Neither the mechanics' lien nor the stop notice is applicable to federal government jobs. Instead, the Miller Act<sup>190</sup> provides that before a federal construction contract that exceeds \$2,000 in amount is awarded, the contractor must furnish both a labor and material payment bond and a faithful performance bond.<sup>191</sup>

## II

### PROPOSALS FOR REFORM

If the present scheme was "confused and confusing" in 1915,<sup>192</sup> it certainly is more so today in view of the perpetual piecemeal change of the basic system. When the rights of the parties directly affected by mechanics' lien law—the owner, the money lender, and the lien claimant—are compared, certain conclusions can be stated with some certainty. The money lender, it appears, is favored at the expense of the lien claimant. The lien claimant often learns that his mechanics' lien is worthless because the construction money trust deed is prior. In addition, the lien claimant has found little comfort in the stop notice as a security

<sup>180</sup> CAL. CODE CIV. PROC. § 1190.1. In fact, much of the confusion of this section is caused by the fact that the section applies to both private and public jobs.

<sup>181</sup> CAL. CODE CIV. PROC. § 1190.1(c).

<sup>182</sup> CAL. CODE CIV. PROC. § 1192.1(a). *But see* CAL. CODE CIV. PROC. § 1190.1.

<sup>183</sup> See OGDEN, CALIFORNIA REAL PROPERTY § 16.11 (1956).

<sup>184</sup> CAL. GOV'T CODE §§ 4200-10.

<sup>185</sup> CAL. GOV'T CODE § 4200.

<sup>186</sup> See CAL. GOV'T CODE §§ 4204-05.

<sup>187</sup> CAL. GOV'T CODE §§ 14371-72, 14374-75.

<sup>188</sup> CAL. GOV'T CODE § 25455.

<sup>189</sup> 41 CAL. JUR. 2D *Public Works and Contracts* § 13 (1958).

<sup>190</sup> 49 Stat. 753 (1935), 40 U.S.C. §§ 270a-e (1958).

<sup>191</sup> 49 Stat. 753 (1935), 40 U.S.C. § 270a (1958). See also Capehart Act § 507, 70 Stat. 1110 (1956), 42 U.S.C. § 1594(a) (1958).

<sup>192</sup> *Roystone Co. v. Darling*, 171 Cal. 526, 546, 154 Pac. 15, 23 (1915) (Henshaw, J., concurring).

device vis-à-vis the money lender. If the lien claimant files a stop notice with the lender who holds the construction loan proceeds, the claimant must in addition file a bond before the stop notice has binding effect on the lender.

It seems equally clear that the owner—particularly the homeowner as opposed to the speculative builder—is the “forgotten man” of mechanics’ lien law. The right of the owner to require a labor and material payment bond pursuant to section 1185.1(c), and thereby limit his lien liability to the contract price of his building contract with his contractor, should be regarded as a constitutional right of the owner.<sup>193</sup> Nevertheless, the homeowner today often is unaware, ill-advised, or simply talked out of his right to require the bond of the contractor.<sup>194</sup> When it is realized that the cost of the bond—and this price includes the price of a faithful performance bond—is but one per cent of the contract price,<sup>195</sup> and when it is realized that governmental units require both the payment bond and the performance bond, it becomes difficult to explain the infrequent use of these bonds in private construction jobs or the failure of the legislature to require that such bonds be obtained for the homeowner’s protection.

There have been a number of proposals directed at correcting the deficiencies of the present system, although these proposals have been piecemeal in the sense that they attempt to change the law without altering the basic scheme. Most of these proposals purportedly have been designed as panaceas for the following problems: (1) the present scheme is objectionable because the owner may be forced to pay twice for his improvement—the so-called double payment problem;<sup>196</sup> and (2) the present scheme is objectionable because it does not provide a reliable security device to the improver of real property.<sup>197</sup> The piecemeal pro-

<sup>193</sup> See note 70 *supra*. Filing this bond also protects the owner from stop notices that may impede the progress of his construction project. CAL. CODE CIV. PROC. § 1190.1(c).

<sup>194</sup> The money lenders have been accused of assisting the contractors in talking the homeowner out of requiring a bond of the contractor. The contractor accompanies the homeowner to the lending institution to discuss a construction loan. While there, the homeowner mentions the possibility of a bond. Since the lending institution appreciates the business that the contractor creates by bringing in homeowners for loans, the lending institution is loath to advise the homeowner to require a bond of the contractor while the contractor is present. See *Hearing of the Senate Interim Judiciary Committee, at the Courthouse, Santa Barbara, California*, Aug. 20 & 21, 1956, at 112–14 [hereinafter cited as *Santa Barbara Hearing*].

<sup>195</sup> See note 246 *infra*.

<sup>196</sup> For example, an owner decides to install a swimming pool in his back yard. A swimming pool contractor agrees to do the job for \$5,000. The swimming pool is constructed and the owner pays the contractor. The contractor, however, does not pay those who supplied him with labor and materials, and these parties assert liens against the owner’s property. If the owner wishes to free his property of the liens he must pay again. One observer has referred to the double payment problem in these terms: “[I]n times of declining economics . . . or when a large subdivision goes haywire, the whole impact of Mechanics’ Lien Law becomes apparent and people begin to wonder what sort of a situation this is where the owner pays twice for the same work or loses his property.” FIFTH PROGRESS REPORT 22 (statement of John A. Bohn, Counsel for the Senate Judiciary Committee).

<sup>197</sup> The lien claimant often finds that his mechanics’ lien is junior to construction money encumbrances for the entire or a substantial amount of the value of the improved property. About this Mr. Behymer has said:

more Mechanics’ Liens remain unfiled than are filed, all by reason of the fact that the party with the inchoate right to file the lien says to himself, “Oh, what’s the use? The lien is of no value because of the denial of the direction and mandate contained in the State Constitution, for I am with a lien right sitting behind a trust deed to which the Legislature has seen fit to give priority over the lien right. There are numerous other lien claimants. The building is incomplete. The holder of the trust deed is about to foreclose it unless I consent to a ten cent on the dollar

posals that have been suggested recently are of three basic types: notice bills, trust fund bills, and bonding bills.

*Notice Bills.* Notice bills are designed to meet the problem of double payment, upon the theory that the owner is ignorant of his rights and that the parties with whom he deals will not enlighten him. Consequently, the notice bills require that the owner must be provided with information about mechanics' lien law.<sup>198</sup> The notice bills are of three basic types—the five-day notice bill, the building-permit bill, and the contractors' notice bill. The five-day bill would place the burden of giving notice upon lien claimants other than contractors.<sup>199</sup> A variation of the five-day bill currently is embodied in Code of Civil Procedure section 1193,<sup>200</sup> which was added in 1959. The building-permit notice bill would place the burden of giving notice upon a governmental agency or body.<sup>201</sup> The contractors' notice

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settlement. I am going to have to hire a lawyer in order to foreclose my lien and I will probably get wiped out by the trust deed."

SENATE JUDICIARY COMM. FOR INTERIM 1957-1959, THIRD PROGRESS REPORT TO THE LEGISLATURE 98 [hereinafter cited as THIRD PROGRESS REPORT]. In addition, the lien foreclosure process is costly and time consuming. THIRD PROGRESS REPORT 99.

<sup>198</sup> Although notice bills would appear to be unobjectionable, lien claimants have opposed them in the past. Materialmen and subcontractors object to the notice bills because of the extra expense that must be incurred in giving the required notice. FIFTH PROGRESS REPORT 61. Some contractors object because they fear that the notice bill may jeopardize their business. THIRD PROGRESS REPORT 77.

<sup>199</sup> One type of five-day bill would require materialmen and subcontractors to give the owner notice that they have contributed labor or materials within five days from the delivery of such contributions. THIRD PROGRESS REPORT 107-08. This bill was objected to because it would be of little value to a home owner unless the home owner fully understood the full text of the Mechanics' Lien Law and what it would mean to him if the contractor should fail to live up to his obligations under his contract. To expect the average home owner who is building his first and probably only house to grasp the intrication [*sic*] of the Mechanics' Lien Law is to ask the impossible.

THIRD PROGRESS REPORT 76. Another variation of the five-day bill provides that the materialman or subcontractor must give notice to the owner of the contractor's default in payment within ten days of such default. A.B. 3302, Cal. Leg., Reg. (Gen.) Sess. (1957).

<sup>200</sup> Section 1193 provides that subcontractors and materialmen—but not laborers—must give notice of their claims of lien to the owner and the contractor no later than fifteen days prior to the time within which claims of lien may be filed. The distinction between laborers and other lien claimants for the purpose of the notice requirement is constitutional despite CAL. CONSR. art. XX, § 15. *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 379 P.2d 1, 28 Cal. Rptr. 697 (1963). Section 1193 was the result of approximately five years of legislative attempts to solve the owner double payment problem. THIRD PROGRESS REPORT 73-109; FIFTH PROGRESS REPORT 20, 119.

<sup>201</sup> One proposal requires the agency or body that issues permits or approval for a work of improvement to send a notice to the property owner containing the following information: (1) Materials and labor contributed to a work of improvement become a lien upon the property until paid for or until the time within which liens may be filed has lapsed. (2) The owner may require the general contractor or the subcontractors to furnish a labor and materials bond pursuant to CAL. CODE CIV. PROC. § 1185.1(c). (3) The owner may require the waiver of lien rights when he pays potential lien claimants. (4) The owner may demand, and the contractor shall be required to furnish, a list of the subcontractors and materialmen who contribute to the work of improvement. (5) The owner is advised to seek competent legal or professional advice to protect his interests. FIFTH PROGRESS REPORT 117, exhibit c. This proposal was objected to by the representative for the Southern Division of the Associated General Contractors as follows:

We feel that it gives some help to the owner, relatively little help, but some to the owner and the help that it does give he certainly should have and we would go along with it, but it does absolutely nothing for the general contractor. In fact, in its present form I assume that it would be unconstitutional, because it requires a list of materialmen and subcontractors here from the general contractor when he has no knowledge of the materialmen and sub-subs that he's dealing with.

FIFTH PROGRESS REPORT 41.

bill would place the burden of giving the required notice upon the contractor.<sup>202</sup>

*Trust Fund Bills.* The trust fund bills are designed to meet the problem of double payment in general and the problem of diversion of construction funds by the contractor in particular.<sup>203</sup> By the terms of one trust fund bill the construction funds paid by the owner to the contractor would be deemed to be a trust fund for the benefit of lien claimants other than the contractor.<sup>204</sup> If the contractor appropriates the funds before he pays such lien claimants, then such appropriation would be evidence of intent to defraud.<sup>205</sup> Another proposal, the mandatory escrow bill, would require the construction funds to be placed in the hands of a third party who would control their disbursement.<sup>206</sup>

*Bonding Bills.* The first variant of the bonding bill proposals is the license bond. A common prerequisite to doing business in California is obtaining a license bond for a fixed amount that enures to the benefit of those who may be prejudiced by the licensee in the course of his business.<sup>207</sup> Although the problems that a license bond is designed to meet would appear to be particularly acute with respect to contractors and subcontractors,<sup>208</sup> at present these parties are not required to obtain such a bond.<sup>209</sup>

<sup>202</sup> One such proposal would require the contractor (1) to notify the owner and the construction money lender of the persons contributing to the improvement, and (2) to furnish the owner and the lender certified material and labor releases before the contractor was paid. THIRD PROGRESS REPORT 77.

<sup>203</sup> There are at least two ways in which a contractor may divert funds: (1) the contractor may take the construction funds from job A to meet his expenses on job B, or (2) the contractor may take the construction funds from job A to spend in Las Vegas. See FIFTH PROGRESS REPORT 78. There currently is a trust fund provision in the statutes, providing that any contractor who appropriates money paid to him for any use or purpose, other than for that which he received it, is guilty of embezzlement, and the payment of laborers and materialmen for work performed or material furnished in the performance of any contract is hereby declared to be the use and purpose to which the contract price of such contract, or any part thereof, received by the contractor shall be applied.

CAL. PEN. CODE § 506. This portion of § 506 has been held an unconstitutional deprivation of equal protection and an unreasonable exercise of the police power. *People v. Holder*, 53 Cal. App. 45, 199 Pac. 832 (1921), 10 CALIF. L. REV. 246 (1922).

<sup>204</sup> See A.B. 1452, Cal. Leg., Reg. (Gen.) Sess. (1957).

<sup>205</sup> *Ibid.*

<sup>206</sup> THIRD PROGRESS REPORT 78. For a similar provision, see CAL. CODE CIV. PROC. § 1189.1(b). The third party escrow function is now served by companies known as builder's control. Builder's controls take possession of the construction funds and pay them out upon a disbursement schedule provided by the owner. These companies are not presently regulated, which has been the cause of some concern. State Bar Report G-1, 1-2; G-2, question 3.

<sup>207</sup> See CAL. AGRIC. CODE § 2348 (agents or employees receiving funds pursuant to marketing law required to file bond); CAL. EDUC. CODE § 6678 (adjustment school officers must file bond if they handle school or student money). Brokers selling securities must, as a prerequisite to obtaining a broker's certificate, file with the California Insurance Commissioner a \$5,000 bond. CAL. INS. CODE § 847. The State Board of Equalization often requires a bond before it will issue a sales tax permit. See CAL. REV. & TAX CODE § 6701; FIFTH PROGRESS REPORT 117. Arizona requires a bond of \$2,000 to \$10,000 for a general contractor's license, depending on the type of license. ARIZ. REV. STAT. ANN. § 32-1152(A) (1) (Supp. 1962).

<sup>208</sup> See THIRD PROGRESS REPORT 77; FIFTH PROGRESS REPORT 78.

<sup>209</sup> Accordingly, it has been proposed that contractors, subcontractors, and joint venturers be required to file with the registrar a surety bond in the amount of \$10,000. The bond would run in favor of the state and the state would control the disbursement of the bond proceeds to unpaid claimants. FIFTH PROGRESS REPORT 116. Probably the principal objections to the license bond are: (1) Since the bond is for a fixed amount, the bond by definition offers only limited protection. (2) The license bond is very expensive. License bond premiums are from

The second variant of the bonding bill proposals is the mandatory labor and material bond, which has been proposed to meet the problem of double payment and the problem of the inadequacy of the mechanics' lien as a security device.<sup>210</sup> Mr. Glen Behymer of the Los Angeles Bar for some time has recommended the following alternative proposals. (1) All construction money encumbrances would be junior to all mechanics' liens even if such encumbrances were recorded prior to the commencement of work, unless a labor and material payment bond was obtained.<sup>211</sup> The lender in effect would become the policeman of the bonding requirement because it would be in his interest to see that the bond was obtained.<sup>212</sup> (2) The lender may cause his encumbrance to become senior to mechanics' liens if the owner under the terms of his building contract retains twenty-five per cent of the contract price until the time within which liens may be filed expires.<sup>213</sup>

The proposals advanced to date have one thing in common: Each assumes the propriety of the present statutes and seeks to remedy particular shortcomings in specific sections.<sup>214</sup> It would seem worthwhile, however, to question whether the contemporary philosophy of mechanics' liens is the most adequate means by which to protect the various participants in construction projects.<sup>215</sup> Amending the statutes in piecemeal fashion to cure specific ills has succeeded in making the statutes prolix without alleviating the underlying problems.

Any system designed to provide special protection to participants in construction projects must balance the interests of the four relevant classes of persons involved: (1) the money lenders;<sup>216</sup> (2) the contractors;<sup>217</sup> (3) the subcon-

five to ten per cent, while the cost of the labor and material payment bond, and the faithful performance bond together currently is about one per cent. Interview with Donald M. Ladd, Associate Superintendent of the Surety Department, Hartford Acc. & Indem. Co., San Francisco, Feb. 5, 1963. See also note 246 *infra*.

<sup>210</sup> See THIRD PROGRESS REPORT 78. These proposals generally would require the contractor to obtain a labor and material payment bond that would enure to the benefit of lien claimants other than the contractor. THIRD PROGRESS REPORT 105. The bond also would serve to limit the owner's lien liability to the contract price of his building contract, as long as the bond met the requirements of CAL. CODE CIV. PROC. § 1185.1(c).

<sup>211</sup> A.B. 2440, Cal. Leg., Reg. (Gen.) Sess. (1953). This bill would amend CAL. CODE CIV. PROC. § 1188.2. The required bond would have to meet the requirements of § 1185.1(c). This alternative has been enacted with respect to § 1184.1 liens in CAL. CODE CIV. PROC. § 1189.1(b).

<sup>212</sup> Since most construction is financed by someone other than the owner, this unique proposal would appear to be particularly efficacious.

<sup>213</sup> This alternative is a throwback to CAL. CODE CIV. PROC. § 1184 prior to the 1911 amendments. Mr. Behymer has commented: "Now, what happened in the days prior to 1911 was that in practically every job, that twenty-five per cent cash holdback was protecting both the owners in the matter of faithful performance of the contract and the laborers, subcontractors and materialmen in the payment of their bills." *Santa Barbara Hearings* 123. This alternative makes allowance for the unbondable contractor and the contractor who does business in areas of the state where it is difficult to obtain bonds. See *Santa Barbara Hearings* 122.

<sup>214</sup> This approach also was followed by the California State Bar committee that studied mechanics' lien law. See generally State Bar Report.

<sup>215</sup> In proposing a trust fund act, Assemblyman Hanna advanced an "omnibus approach" in which he considered the various parties involved in the construction area rather than restricting consideration to one particular class. FIFTH PROGRESS REPORT 77. Apparently part of the "omnibus" was not a reconsideration of the entire mechanics' lien system, however.

<sup>216</sup> Title insurance companies would be included incidentally under "money lenders," for the title insurance companies assure the money lender that his encumbrance will be prior to any lien claimants.

<sup>217</sup> This term is used broadly so that it includes the speculative builder or the owner building for resale as well as the "general" or "prime" contractor.

tractors, materialmen, and mechanics;<sup>218</sup> and (4) the property owners.<sup>219</sup> The present statutes, in addition to being complicated, have resulted in affording a preferred position to the money lenders vis-à-vis the lien claimants, and to the lien claimants vis-à-vis the property owners.<sup>220</sup> In considering broad reform, methods should be examined that would permit these four classes to be placed in approximately equal positions.<sup>221</sup>

#### *A. Elimination of the Statutory Security Device*

A pregnant question is whether the modern construction industry requires special credit protection. Since the state constitution provides for the right of certain persons<sup>222</sup> to a mechanics' lien, it might be supposed that the supreme court has provided the definitive answer to this question in the following words:

The fact that the constitution confers upon persons performing labor or furnishing materials for the construction of a building the right to a lien thereon, at once establishes these persons as a class, and makes a constitutional distinction between them and all other persons making contracts. This justifies legislation for the benefit of such claimants and governing the conduct and contracts of the owner of the property and the person contracting to construct buildings thereon.<sup>223</sup>

For at least three reasons, it seems legitimate to inquire whether an analysis of the needs of the modern construction industry should begin and end with the Constitutional Convention of 1879: (1) the right to a mechanics' lien was never recognized at common law or in equity;<sup>224</sup> (2) the framers of the 1879 constitution<sup>225</sup> were not themselves fully agreed that a provision should be made in the constitution for mechanics' liens;<sup>226</sup> and (3) one of the classes that was designed

<sup>218</sup> These three terms together are used broadly to include all those who contribute to an improvement but are not contractors.

<sup>219</sup> Probably the speculative builder should not be included in the "property owner" classification for this purpose. The property owners who suffer from mechanics' liens are the parties who ultimately consume the improvement. See FIFTH PROGRESS REPORT 80.

<sup>220</sup> See notes 193-95 *supra* and accompanying text.

<sup>221</sup> This comment does not consider specific reforms to specific statutes that may be desirable. That was done in part by the California State Bar committee. See generally State Bar Report.

<sup>222</sup> It should be remembered that the constitutional right to a lien applies only to certain classes—"mechanics, materialmen, artisans and laborers of every class." CAL. CONST. art. XX, § 15. Contractors, subcontractors, and other persons who contribute to a work of improvement have the right to a lien only as a matter of legislative grace, except insofar as their work qualifies them as "mechanics, materialmen, artisans and laborers."

<sup>223</sup> *Roystone Co. v. Darling*, 171 Cal. 526, 543, 154 Pac. 15, 22 (1915).

<sup>224</sup> *Spinney v. Griffith*, 98 Cal. 149, 32 Pac. 974 (1893).

<sup>225</sup> The constitution of 1849 contained no provision about mechanics' liens. See *Nofziger Lumber Co. v. Solomon*, 13 Cal. App. 621, 110 Pac. 474 (1910).

<sup>226</sup> One delegate thus remarked:

At every session, the mechanics of San Francisco send a man here for the purpose of getting the lien law in good position; the result has been confusion worse confounded all the time. This whole thing is infirm in principle; they want to make the man who is going to build a house, the insurer for the fulfillment of a contract with a third person.

3 PROCEEDINGS OF 1879 CALIFORNIA CONSTITUTIONAL CONVENTION 1417 (1881) (remarks of Delegate Shafter).

to be protected by the constitutional provision—mechanics<sup>227</sup>—apparently no longer requires such protection.<sup>228</sup>

Apart from the constitutional distinction,<sup>229</sup> the proper analytical question appears to be: "Is there a valid distinction to be made between members of the construction industry and 'all other persons making contracts' that justifies special credit protection for this class?"<sup>230</sup> It is submitted that the only proper argu-

<sup>227</sup> Whether the constitutional provision would have been enacted if the mechanics had not been included within the protected classes is somewhat doubtful in light of the following remarks of one delegate:

I understand why the workman should be a preferred creditor, but I don't understand why the lumberman should be a preferred creditor. There has been no good reason urged here why he should stand on any better ground than any other creditor. Certainly lumber dealers are capable of looking out for their own interests. If they are not satisfied as to the solvency of the creditor then let them get security.

3 PROCEEDINGS OF 1879 CALIFORNIA CONSTITUTIONAL CONVENTION 1394 (1881) (remarks of Delegate Dudley).

<sup>228</sup> Mechanics, in the sense of laborers or workmen, must be paid by law twice every month on predesignated paydays. CAL. LAB. CODE § 204. If the laborer is not paid on the designated payday, his employer is guilty of a misdemeanor. CAL. LAB. CODE § 215. Failure to post conspicuously a notice specifying the regular paydays and the time and place of payment is prima facie evidence of the misdemeanor. CAL. LAB. CODE § 215. In addition, the employer must pay a fine of \$10 to the state for each failure to pay each employee. CAL. LAB. CODE § 210. The Division of Labor Law Enforcement is directed to inquire diligently for violations and to institute action in proper cases.

In Alameda County, laborers are customarily paid each Friday. If the employer misses the payday, the laborer will report this fact to his union and the union will then contact the employer in an effort to reach a settlement. If no settlement is forthcoming, the union will advise the laborer to assign his claim to the Division of Labor Law Enforcement, which will then make a demand upon the employer for the amount of the laborer's claim. If the employer disputes the claim, the division will convene a hearing. In a proper case, the division will refer the matter to the district attorney for appropriate action. The division reports that the mechanics' lien is used only as a last resort, because ordinarily it is the employer and not the owner who has caused the wages to be delinquent. Telephone Interview With Division of Labor Law Enforcement, Oakland Office, April 25, 1963.

At a hearing on mechanics' liens in 1956, one contractor reported:

In my own instance, since we have been in business in thirty-eight, I don't know of any mechanic that has had occasion to file lien for his labor on any of the jobs that I have been in contact with because if he doesn't get his money at the end of the week we hear about it right now.

*Santa Barbara Hearing* 144 (remarks of Mr. Walter Keusder). This report would appear to be supported by the following excerpt from a telephone interview with a union representative:

Q. Do you ever have occasion to use the mechanics' lien?

A. A who?

Confidential Telephone Interview, April 25, 1963. Additionally, although over forty representatives of contractors, subcontractors, and materialmen attended, it may be significant that labor was not represented at the 1958 meeting of "interested individuals in the construction industry" to present a united front to the legislature with respect to the mechanics' lien laws. See FIFTH PROGRESS REPORT 19-20.

<sup>229</sup> The analytical question here presented goes beyond the scope of the recent hearings of the Senate Interim Judiciary Committee with respect to the mechanics' lien laws. For example:

Mr. Keusder: I personally believe that the construction industry would be in a much healthier condition if we didn't have the lien law and the material dealers had to rely on normal business credit operations in qualifying their customers. I think you would have a much better class of subcontractors and you wouldn't have the trouble that you have today.

Senator Regan: That's out. It's in the constitution.

*Santa Barbara Hearing* 156.

<sup>230</sup> This question has been stated negatively in the following terms:

More and more each day I hear the Lien Law being referred to as class legislation. It grants to the building material merchant and the subcontractor a special privilege

ments in support of a statutory security protection are those which are relevant to show that the construction industry in some way is unique vis-à-vis other industries. In addition, the desirability of protecting each member<sup>231</sup> within the industry should be separately considered. Ideally the relevant arguments should be economic or social but inevitably they will be political.

### *B. Retention of the Statutory Security Device*

#### *1. The Stop Notice Plan*

Assuming the desirability of providing special treatment for the participants in construction projects, one means by which to preserve special security devices while eliminating some of the problems of the present system would be: first, to provide the lien remedy only for contractors; and second, to preserve the stop notice remedy for subcontractors, materialmen, and mechanics.

Restricting the lien remedy to contractors would provide contractors with the same remedy that they have at present, since the stop notice procedure is available only to those working under the contractor.<sup>232</sup> The position of the money lenders would not be affected unless the priorities provisions were changed.<sup>233</sup> The parties that would be affected substantially would be the property owners and the subcontractors, materialmen, and mechanics. The purpose of restricting the lien remedy to the contractor would be to protect the owner's property from unknown lien claimants.<sup>234</sup> The owner would be hypothecating his property only to those with whom he was in privity, for there would be no need for statutory agency.

Subcontractors, materialmen, and mechanics clearly would lose the lien remedies currently available to them, but they need not necessarily be in a worse position. Any loss of protection to those classes presumably would be necessary in order to put the property owner in a position approximating that of the other

not enjoyed by other merchants and businessmen. If the butcher or baker extends credit, he cannot collect from a third person. Why should anyone be required to pay another's obligations? The Lien Law and the Public Works Bond Act foster unjustifiable credit to irresponsible contractors and are a detriment to the ethical material supply houses.

*Santa Barbara Hearings 25* (remarks of Mr. Robert R. Boyd).

<sup>231</sup> The California Supreme Court has recently decided that a constitutional distinction may be made between members of the construction industry. The court thus held that there was a valid distinction between laborers and other classes protected by the constitutional provision with respect to the requirement of CAL. CODE CIV. PROC. § 1193 that lien claimants give notice to the owner and to the contractor preliminary to filing their claims of lien. *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 379 P.2d 22, 28 Cal. Rptr. 697 (1963).

<sup>232</sup> CAL. CODE CIV. PROC. § 1190.1(a).

<sup>233</sup> The money lenders presently are able to obtain encumbrances that are prior to lien claims by recording before work on the improvement is commenced. See CAL. CODE CIV. PROC. § 1188.1.

<sup>234</sup> At present, parties dealing with statutory agents of the owner are able to secure liens against the owner's property. CAL. CODE CIV. PROC. § 1181, 1182(c). The owner may have no idea who his statutory agents are. It is clear that subcontractors are statutory agents so that persons dealing with subcontractors—whether or not the owner has anything to do with the selection of the subcontractors—are entitled to liens in the owner's property. CAL. CODE CIV. PROC. §§ 1181, 1182(c). It is possible that anyone having control of a part of the work of improvement is a statutory agent, so that persons with whom he deals are entitled to a lien. See note 20 *supra*. Unless the owner was sufficiently familiar with the intricate provisions of mechanics' lien law to protect himself by requiring bonds, his property is at the mercy of persons with whom he has no privity and of whose existence he may be unaware.

persons involved in construction. Subcontractors, materialmen, and mechanics could suffer somewhat since the stop notice remedy only permits garnishing the funds that the owner owes his contractor.<sup>235</sup> If the owner owes no money, then there are no funds to be garnished. The stop notice remedy could be strengthened somewhat so that it would provide subcontractors, materialmen, and mechanics with better protection without sacrificing the interests of the owner. Specifically, the stop notice could be made more effective by permitting funds in the hands of a money lender to be garnished without a bond.<sup>236</sup>

Effectuating this plan would be fairly simple. The present mechanics' lien statutes would have to be redrafted to eliminate statutory agency and to define "contractor" in terms of a contractual relationship with the owner. The contractors' lien statutes that are proposed in this comment do this.<sup>237</sup> The present stop notice statutes could stand redrafting to make them more comprehensible. Conceivably, however, there may be possible constitutional problems with a proposal of this nature.<sup>238</sup>

<sup>235</sup> CAL. CODE CIV. PROC. § 1190.1(c).

<sup>236</sup> At present, a bond is required in order to assert a stop notice against funds held by a money lender. CAL. CODE CIV. PROC. § 1190.1(h).

<sup>237</sup> See appendix A.

<sup>238</sup> By constitutional fiat, "Mechanics, materialmen, artisans, and laborers of every class, shall have a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished; and the Legislature shall provide, by law, for the speedy and efficient enforcement of such liens." CAL. CONST. art. XX, § 15. The constitutional provision does not take property without due process, for the owner contracts voluntarily and subject to the state constitution and statutes. *Hollenbeck-Bush Planing Mill Co. v. Armweg*, 177 Cal. 159, 170 Pac. 148 (1917). The constitutional provision is operative only "as supplemented by legislative action. So far as substantial benefits are concerned, the naked right, without the interposition of the legislature, is like the earth before creation, 'without form and void;' or, to put it in the usual form, the constitution in this respect is not self-executing." *Spinney v. Griffith*, 98 Cal. 149, 151-52, 32 Pac. 974, 975 (1893); *accord*, *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 379 P.2d 1, 28 Cal. Rptr. 697 (1963); *Morris v. Wilson*, 97 Cal. 644, 32 Pac. 801 (1893); *Standard Pipe & Supply Co. v. Red Rock Co.*, 57 Cal. App. 2d 897, 135 P.2d 659 (1943); *Ferger v. Gearhart*, 44 Cal. App. 245, 186 Pac. 376 (1919). *But see* *English v. Olympic Auditorium*, 217 Cal. 631, 20 P.2d 946 (1933); *Miltimore v. Nofziger Bros. Lumber Co.*, 150 Cal. 790, 90 Pac. 114 (1907); *Burr v. Peppers Cotton Lumber Co.*, 91 Cal. App. 268, 266 Pac. 1925 (1928). The courts have permitted considerable legislative leeway. Although the right to the lien cannot be removed by the legislature without constitutional authority or for public policy reasons, *Goldtree v. City of San Diego*, 8 Cal. App. 505, 97 Pac. 216 (1908); see *Hanmond Lumber Co. v. Barth Inv. Corp.*, 202 Cal. 606, 262 Pac. 31 (1927), the legislature may provide that the constitutional lien is lost if the claimant fails to follow statutory conditions precedent, *Morris v. Wilson*, 97 Cal. 644, 32 Pac. 801 (1893). Even though the lien is not to be interpreted as "a general law relating to contracts and contractual relations," *Los Angeles Pressed Brick Co. v. Higgins*, 8 Cal. App. 514, 97 Pac. 414 (1908), the legislature may provide that the amount lien claimants can recover is limited to the amount of the contract price, *Roystone Co. v. Darling*, 171 Cal. 526, 154 Pac. 15 (1915). The legislature may not impair the lien right or unduly hamper its exercise "by a cumbersome or ultratechnical scheme designed for the enforcement of the right of lien," *Diamond Match Co. v. Sanitary Fruit Co.*, 70 Cal. App. 695, 234 Pac. 322 (1925), but "it is evident that there is no constitutional compulsion for uniform treatment, and that the Legislature could, if it chose, adopt one method for the enforcement of materialmen's rights and a second, entirely different procedure for the enforcement of laborers' rights." *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 250, 379 P.2d 1, 3, 28 Cal. Rptr. 697, 699 (1963). A concurring opinion once noted that the permissible legislative latitude was so great that the legislature constitutionally could provide for a means by which the materialmen would have no lien at all. *Roystone Co. v. Darling*, 171 Cal. 526, 545, 154 Pac. 15, 23 (1915) (Henshaw, J., concurring). Consequently, it would seem that the legislature would be meeting the constitutional require-

## 2. The Bonding Plan

Assuming the conclusion that special protection is desirable for classes engaged in construction activity, one method of providing this protection is through compulsory bonding. It would be possible, of course, to impose mandatory bonding upon the industry without molesting the present mechanics' lien statutes,<sup>230</sup> but an adequate bonding requirement would make unnecessary the cumbersome remedies currently provided.<sup>240</sup>

Basically, a bonding system would require individuals in the construction industry to bond themselves for the protection of those working under them. Subcontractors, materialmen, and mechanics who were protected by a bond would have relatively little concern with the propensities of either the contractor or the homeowner to lead idle and dissolute lives. If the contractor were bonded, then the subcontractors, materialmen, and mechanics could proceed against the bond in the event that they were not paid.<sup>241</sup> To an extent, even the money lenders would benefit from a bonding system insofar as the bonds make unnecessary security interests in real property that otherwise might deprive the money lender of his security interest. It is possible that contractors themselves would benefit from mandatory bonding. If bonds were made a condition precedent to doing business as a contractor, then the irresponsible contractor who is unbondable by a corporate surety would be unable to do business. Conceivably this would tend to eliminate

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ments by providing that the sundry mechanics, materialmen, artisans, and laborers of every class would have a lien if they met the condition precedent of being in the class defined as "contractors." Mechanics, materialmen, artisans, and laborers of every class who were not contractors would be cared for by the stop notice procedure; the legislature, in the exercise of its police power, would be providing different remedies for different classes in an effort to harmonize the needs of property owners and participants in construction activity. See *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 251, 379 P.2d 1, 8, 28 Cal. Rptr. 697, 699 (1963); *Roystone Co. v. Darling*, 171 Cal. 526, 154 Pac. 15 (1915); *Alta Bldg. Material Co. v. Cameron*, 202 Cal. App. 2d 299, 20 Cal. Rptr. 713 (1962). *But see* *English v. Olympic Auditorium*, 217 Cal. 631, 20 P.2d 946 (1933); *Miltimore v. Nofziger Bros. Lumber Co.*, 150 Cal. 790, 90 Pac. 114 (1907); *Burr v. Peppers Cotton Lumber Co.*, 91 Cal. App. 268, 266 Pac. 1025 (1928); *Ferger v. Gearhart*, 44 Cal. App. 245, 186 Pac. 376 (1919); *Goldtree v. City of San Diego*, 8 Cal. App. 505, 97 Pac. 216 (1908). If the proposal advanced in the text were enacted, it probably would be wise to repeal the constitutional provision. Even though this might prove to be an abundance of caution, repealing § 15 might be desirable independently, particularly since it is unclear that the lien remedy is the most satisfactory method by which to deal with the construction industry. See discussion in part II, A, following note 221 *supra*.

<sup>230</sup> The notion of requiring bonds is not novel. One suggestion contemplated adding additional sections to the present mechanics' lien statutes, requiring bonds for improvements costing over \$25,000. See State Bar Report, G-1, 1-7.

<sup>240</sup> One attorney concluded:

[T]he important thing in any new legislation for the protection of lien claimants is an adequate bond substitution, which bond substitution was upheld by both the majority and the concurring opinion in the Roystone case [*Roystone Co. v. Darling*, 171 Cal. 526, 154 Pac. 15 (1915)]. That is really the only thing that will properly and fairly and justly protect every interest concerned in the building industry, from owner to those who have furnished labor and materials, and will be fair and just to the lending institutions, as it takes into consideration all the practicalities of the present method of doing business and improves the solidity of an industry which today is far from solid.

Letter From Mr. Glen Behymer of the Los Angeles Bar, to the *California Law Review*, April 18, 1963.

<sup>241</sup> The surety who bonded a contractor would be quite concerned with his propensities to tend to things other than business. A labor and material bond is written for each job, and the surety considers the business acumen of the contractor with regard to the specific job. See *Hartford Acc. & Indem. Co.*, *Contract Bond Course*, Jan. 1962, pp. 2, 5.

marginal elements from the industry, with a stabilizing effect.<sup>242</sup> It is unclear, however, to what extent bonds could not be obtained.<sup>243</sup> Contractors also could benefit from the surety's independent evaluation of the contractor's prospects on a given job. The surety would be concerned with the experience, financial resources, and uncompleted work on hand of the contractor, and with the amount of and the kind of contract under consideration.<sup>244</sup> If the surety was unwilling to bond the contractor because the underwriter felt that the contractor would not succeed, then the contractor might consider re-evaluating his bid. Although he lost the job, he may have been saved from financial ills.

The cost of bonds may raise building costs somewhat, although this is unclear. To the extent that prices in the construction industry are inflated by reliance on the property lien for payment,<sup>245</sup> prices should tend to decrease because the merchant extending credit will know that the bill will be paid. Even if building costs were increased, the contractor would pass the bond cost to the property owner. Since the bonds greatly benefit the property owner by insuring that his property will not be subject to liens, it might prove cheaper in the long run for all homeowners to pay slightly more for construction in order to spare some homeowners from having to pay twice for an improvement. In part, a bonding statute that protects homeowners assumes the absence of legal sophistication on the part of homeowners; if homeowners as a class are to be protected, it seems fair to require them to bear the cost of that protection, particularly when the cost is minimal.<sup>246</sup>

It is difficult to discuss bonding in the abstract when dealing with the concrete problems of the construction industry. This comment includes a set of statutes

<sup>242</sup> The building industry today is considered somewhat unstable. See note 240 *supra*.

<sup>243</sup> Apparently sureties will not write bonds if they fear that the contractor could not manage the job. See Hartford Acc. & Indem. Co., Contract Bond Course, Jan. 1962, p. 5. It is unclear whether unbondable contractors would be forced to act in a capacity that would not require a bond or would be forced to go out of business. Apparently the bonding business differs substantially from the insurance business so that an "assigned risk" pool would be impractical. See generally Hartford Acc. & Indem. Co., Contract Bond Course, Jan. 1962.

<sup>244</sup> Hartford Acc. & Indem. Co., Contract Bond Course, Jan. 1962, p. 5.

<sup>245</sup> See FIFTH PROGRESS REPORT 78. See also *Santa Barbara Hearings* 144-45, where it was said:

[My first instructions when I went with a small flooring wholesaler were:] "Well, you are not going to get much business from the good contractors, because they're pretty well tied up with the big operators, but get after the little fellows that don't have credit, etc. We got our lien rights to take care of us and if you bring the business in, we'll check the credit and if the job is good for it, we'll take the business."

It has been observed that no prudent materialman would extend credit solely on the basis of lien rights. Letter From Mr. Richard C. Dinkelspiel, Member of the San Francisco Bar, to the *California Law Review*, April 24, 1963.

<sup>246</sup> The cost of a labor and performance bond does not vary according to the financial responsibility and the experience of the applicant. The premium charge is determined by the type of bond and its hazards. Hartford Acc. & Indem. Co., Contract Bond Course, Jan. 1962, p. 2. Surety companies commonly distinguish between the types of bonds they issue on construction jobs. For instance, Hartford Accident and Indemnity Co. designates contracts for the construction of buildings as class "B." The rate charged for class "B" bonds is one per cent of the contract price on the first \$100,000 and approximately three-fifths of one per cent on the next \$2,400,000. Such construction as bridges, highways, painting, and roofing is designated class "A" contracts. The premium on the class "A" bond is somewhat lower than the class "B." The rate for the class "A" bond is three-fourths of one per cent on the first \$100,000 of the contract price and one-half of one per cent on the next \$2,400,000. These rates are based on the contract price and not on the bond amount. Labor and material bonds cost the same as labor, material, and performance bonds. Telephone Interview with Donald M. Ladd, Associate Superintendent of the Surety Department, Hartford Acc. & Indem. Co., April 26, 1963.

designed to make bonding mandatory for improvements to real property.<sup>247</sup> It is submitted that these statutes provide the groundwork for a comprehensive revision of mechanics' lien law if it is decided that mandatory bonds should be required.

The proposed statutes require the contractor to bond himself for the benefit of subcontractors, materialmen, and mechanics.<sup>248</sup> A labor and material bond is required for each improvement.<sup>249</sup> "Improvement" for bonding purposes depends on the contractor's contract with the owner,<sup>250</sup> so that there could be a number of "improvements" involved in one construction project if there were a number of contractors. Each contractor would be required to bond himself. No bond is required of the ordinary property owner having an improvement built for his own use; but the speculative builder is considered to be a "contractor" so that he is required to bond himself.<sup>251</sup> If the speculative builder owns the property, then he *also* is an "owner," so the segregated contractors are required to bond themselves.

The proposed statutes eliminate the conventional mechanics' lien as it exists today, but do preserve the lien remedy in certain instances. Since the ordinary property owner is not required to bond himself, the lien right is preserved for the contractor.<sup>252</sup> Conceivably the property may be an inadequate security in some instances so that it would be desirable for the owner to bond himself to insure payment to the contractor. The proposed statutes make no provision for this, but assume that the contractor—as opposed to the homeowner—has had sufficient contact with the building industry to require a bond for his protection when one is needed. As a concession to the practical problems that might arise from requiring bonds for very small jobs, the statutes do not require a contractor to bond himself when the contract price is less than \$1,000.<sup>253</sup> In such cases, the parties under the contractor are permitted to assert liens against the owner's property.<sup>254</sup> This lien is somewhat different from the present mechanics' lien, however, for these claimants sue on the contractors' lien right. If the contractor refuses to assert a lien, then these parties may force him to do so. Admittedly this procedure is awkward, but it seems preferable to requiring a contractor to secure a bond to install a water heater. Furthermore, preserving lien rights for these small jobs, along with the lien right for contractors, would have the advantage of placing the proposed statutes beyond the reach of constitutional objection.<sup>255</sup>

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<sup>247</sup> These statutes are included in appendix A.

<sup>248</sup> Proposed Cal. Bus. & Prof. Code § 7077.2, appendix A. The proposed statutes do not require the contractor to obtain a performance bond for the benefit of the owner. He is required only to obtain a labor and material bond for the benefit of those working under him. Probably it would be reasonable to require a performance bond as well as a labor and material bond since the cost would be the same. See note 246 *supra*.

<sup>249</sup> Proposed Cal. Bus. & Prof. Code § 7077.2, appendix A. The contractor is not compelled to obtain a license bond.

<sup>250</sup> Proposed Cal. Bus. & Prof. Code § 7077.1(g), appendix A.

<sup>251</sup> Proposed Cal. Bus. & Prof. Code § 7077.1(c), appendix A.

<sup>252</sup> See proposed Cal. Code Civ. Proc. § 1180.03, appendix A.

<sup>253</sup> Proposed Cal. Bus. & Prof. Code § 7077.2(a)(1), appendix A.

<sup>254</sup> Proposed Cal. Bus. & Prof. Code § 7077.8, appendix A.

<sup>255</sup> There are two constitutional problems with mandatory bonding statutes: (1) unconstitutional deprivation of the right to contract; and (2) unconstitutional deprivation of the rights secured to certain classes by CAL. CONST. art. XX, § 15.

(1) In *Roystone Co. v. Darling*, 171 Cal. 526, 532, 154 Pac. 15, 17 (1915), the court stated that CAL. CONST. art. I, § 1 declares:

all men possess "certain inalienable rights," among them the right of "acquiring,

The proposed statutes also eliminate stop notices. The stop notice presently protects only subcontractors, materialmen, and mechanics;<sup>256</sup> since these classes would be protected by the contractors' bond, the stop notice would serve only as an alternative remedy. There would seem to be little reason for retaining stop notices as an alternative remedy when the protected classes can proceed against a corporate surety for their money, but could use the stop notice—if available—effectively to shut down a project.<sup>257</sup> Retaining the stop notice with adequate bonding statutes would seem to provide subcontractors, materialmen, and mechanics with unnecessarily great protection at the expense of contractors and property owners.

The proposed statutes seek to balance as evenly as possible the interests of the four groups involved. (1) The money lenders would not be affected substantially. The proposed statutes would eliminate many of the possible lien claims against the property. For the most part, the money lender would be able to ascertain the identity of potential lien claimants by discovering the parties with whom the owner had contracted. This would permit the money lender to loan money even after work has commenced by securing subordination agreements from the possible lien claimants. The money lender still would be permitted to obtain a prior security interest in the property by recording his encumbrance before work was commenced.<sup>258</sup>

(2) Presumably the contractor is a businessman sufficiently sophisticated to determine the extent of his security before beginning work. If there is little security against which to assert a contractors' lien, then the contractor would be well advised to obtain a bond from the owner to insure payment; otherwise he should not do the work. The contractor should benefit from the proposed statutes to an extent. Although it is conceivable that building costs would be increased somewhat by the cost of bonds, all contractors would be bearing substantially the same expense so there would be no competitive advantages. The contractor would have the benefit of the surety's second-guessing the sufficiency of his contracts. The surety would seem to be in a good position to police construction contracts, since that is part of his business.

possessing, and protecting property," . . . which includes the right to contract concerning the use, enjoyment, and disposition of property, and which cannot be taken away or restricted by the Legislature except by reasonable regulations made in the exercise of the police power.

CAL. CONST. art. XX, § 15 has been read to mean that it does not impair these property rights. Consequently, mandatory bonds that were unconstitutional resulted in the owner's being liable for a greater amount than for which he had contracted with the contractor. As long as the mandatory bond statute does not subject the owner to greater liability than that for which he contracted, there is no unconstitutional impairment of the right to contract. See *Roystone Co. v. Darling, supra*; *cf. Hartford Acc. & Indem. Co. v. Nelson Mfg. Co.*, 291 U.S. 352 (1934).

(2) Despite the seemingly clear wording of CAL. CONST. art. XX, § 15, see note 238 *supra*, the legislature may deprive some of the protected classes of lien rights if adequate bond protection is substituted. See *Roystone Co. v. Darling, supra*. The statutes that are proposed in appendix A preserve the lien rights in some instances, so that not all of the persons listed in article XX, § 15 are required to rely on the bond. The legislature can discriminate between "laborers" and other classes of improvers in its legislation, see *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 379 P.2d 1, 28 Cal. Rptr. 697 (1963), so there would seem to be no reason why it could not apportion remedies on the basis of the contract price.

<sup>256</sup> CAL. CODE CIV. PROC. § 1190.1.

<sup>257</sup> Preventing the contractor from getting money may halt construction. See text accompanying note 162 *supra*.

<sup>258</sup> Proposed Cal. Code Civ. Proc. § 1180.17, appendix A.

(3) Subcontractors, materialmen, and mechanics would benefit greatly from the proposed statutes. Instead of looking to the uncertain value of improved property for security, they would look to a corporate surety. These classes would have to provide information to sureties in order to recover on the bond,<sup>259</sup> but this burden should not be onerous and would seem to be a reasonable price for such protection.

(4) The property owner also would benefit greatly from the proposed statutes. At present, the owner hypothecates his property to support as much of the construction industry as may contribute to the improvement that he has ordered. His property may be sold to satisfy the claims of persons of whom he had never heard, and who had contracted with a statutory agent of whom he had no knowledge. There is, of course, provision in present law for the owner to require a bond for his protection,<sup>260</sup> but the homeowners who need this protection because they are dealing with marginal contractors may not be sufficiently familiar with the intricacies of mechanics' lien law to realize that they need a lawyer at their elbow. The proposed statutes place the burden of being familiar with the law on those who are in the business and can be expected to be cognizant of provisions applicable to them. Ultimately responsibility will vest in the contractor, for his surety must respond to the claims of all who contribute to the improvement,<sup>261</sup> and the surety then would recover from the contractor for amounts expended.<sup>262</sup> The homeowner hypothecates his property only to those with whom he deals.

### III

#### CONCLUSION

It has been the purpose of this comment to demonstrate the need for the reform of mechanics' lien law.<sup>263</sup> Our own proposals have been set forth in detail in the hope that they will serve as convenient reference until other comprehensive proposals are similarly presented. Perhaps our proposals also will inspire comment and criticism with the objective of the total abolition or complete reform of California mechanics' lien law.

*Charles Evans Goulden*  
*Conrad Rushing\**  
*James G. Seely, Jr.*

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<sup>259</sup> See proposed Cal. Bus. & Prof. Code § 7077.4(b), appendix A.

<sup>260</sup> CAL. CODE CIV. PROC. § 1185.1(c).

<sup>261</sup> Proposed Cal. Bus. & Prof. Code § 7077.2, appendix A.

<sup>262</sup> To alleviate any questions, the agreement for the bond usually provides that the contractor is required to reimburse the surety for any expenditures that the surety is compelled to make on the contractor's behalf. See Hartford Acc. & Indem. Co., Contract Bond Course, Jan. 1962, p. 2.

<sup>263</sup> Apparently the Supreme Court of California agrees that a legislative reappraisal of mechanics' liens would be appropriate. See *Borchers Bros. v. Buckeye Incubator Co.*, 59 A.C. 246, 379 P.2d 1, 28 Cal. Rptr. 697 (1963).

\* Member, Class of 1963.

## APPENDIX A

## DRAFT STATUTES FOR CONTRACTORS' LIENS AND MANDATORY BONDS

These statutes are designed to provide satisfactory security devices to all improvers of real property at reasonable expense to the public. This is done in two ways: (1) by preserving the lien upon real property for the contractor class, and (2) by imposing a mandatory bonding requirement on contractors for the benefit of those working under them. The contractors' lien essentially is a redrafted version of present mechanics' lien law, with some of the more objectionable features eliminated and reference to classes other than the contractor deleted. The lien remedy is drafted for the Code of Civil Procedure and the mandatory bond requirements for the Business and Professions Code, although there is no reason why these statutes could not be placed in other codes should there be any that are more appropriate. The contractors' lien provisions could serve as a starting point for any comprehensive revision of present mechanics' lien law that eliminated the concepts of statutory agency and work of improvement. The mandatory bond statutes are one means of protecting present lien claimants who work under the contractor.

*An act to amend Chapter 2 (commencing with Section 1181) of Title IV, Part Three of the California Code of Civil Procedure, relating to liens for the construction industry; and to add Article 5.5 (commencing with Section 7077) to Chapter 9 of Division 3 of the California Business and Professions Code, relating to bonding requirements for the construction industry.*

*The people of the State of California do enact as follows:*

SECTION 1. Chapter 2 of Title IV of Part Three of the California Code of Civil Procedure is repealed.

SECTION 2. Chapter 2 (commencing with Section 1180.01) is added to Title IV of Part Three of the California Code of Civil Procedure to read as follows:

## CHAPTER 2. CONTRACTORS' LIENS

## ARTICLE I

*Definitions*

§ 1180.01. DEFINITIONS.—In this chapter, unless the context or subject matter otherwise requires:

- (a) *Commenced*.—An improvement is “commenced” when work is begun on an improvement.<sup>1</sup>
- (b) *Contract Price*.—The “contract price” is the amount that the owner agrees to pay the contractor for an improvement.<sup>2</sup>

*Comment to § 1180.01(b).* If the contract is of the “cost plus” variety, by which the contractor agrees to build the improvement for his costs plus a stated percentage for his profit, then the contract price is “cost plus” and can be given only an estimated dollar value.

- (c) *Contractor*.—A “contractor” is one who contracts directly with the owner with regard to all or part of an improvement.

*Comment to § 1180.01(c).* The definition of “contractor” is made to depend upon the relationship between the owner and one who improves real prop-

<sup>1</sup> The present statutes use the word “commenced” in a number of places but do not define the word. See, e.g., CAL. CODE CIV. PROC. §§ 1188.1, 1189.1.

<sup>2</sup> The present statutes also are concerned with “contract price” but do not define the term explicitly. See CAL. CODE CIV. PROC. § 1185.1.

erty. Making the definition hinge upon contractual relationships is necessary in order to depart as much as possible from the "work of improvement" concept.

It should be noted that there could be a number of contractors involved in a single construction project. A speculative builder using the segregated contract method, whereby he contracts with a number of people for aspects of the work, would be dealing with a number of contractors. Each would be entitled to a lien.<sup>3</sup>

- (d) *Extras*.—"Extras" are work or materials not included in the original contract but used in the improvement at the instance of the owner.
- (e) *Furnish Materials*.—To "furnish materials" is to provide materials for the improvement or to fabricate specially materials for the improvement, pursuant to contract.

*Comment to § 1180.01(e)*. This definition is intended to accomplish three things: (1) state some specific grounds for determining when a contractor has furnished materials; (2) make it clear that the contractor need not deliver the materials to the jobsite as long as they were furnished pursuant to contract for the specific improvement;<sup>4</sup> and (3) eliminate the problem of specialty work being done away from the jobsite.<sup>5</sup>

- (f) *Improve*.—To "improve" is to furnish work or materials that benefit or are intended to benefit real property. Illustrative of works that improve are building, demolishing, excavating, surveying, landscaping, and plumbing.
- (g) *Improvement*.—An "improvement" is an addition or modification that improves real property. For the purposes of this chapter, except as otherwise provided herein, "work of improvement" and "improvement" mean the entire structure or scheme of improvement as a whole. Except for determining the time at which an improvement was "commenced," as that term is defined herein, the extent of a "work of improvement" or "improvement" is determined by the contract with the owner.

*Comment to § 1180.01(g)*. This includes the present language of section 1182(b)<sup>6</sup> to preserve the decisional law defining "work of improvement." The work of improvement concept is retained for the limited purpose of determining priority; all contractors' liens are of equal priority since all date from the commencement of the work of improvement without reference to the various contracts. For all other purposes, however, "work of improvement" depends upon the owner's contract with the contractor in order to avoid the work of improvement concept and make the lien depend upon contractual privity.<sup>7</sup>

- (h) *Mail*.—To "mail" is to deposit with the Post Office Department. Postage must be paid, and the envelope must be addressed and sent by registered or certified mail.
- (i) *Materialman*.—A "materialman" is one who furnishes materials for an improvement but who is not a mechanic, contractor, or subcontractor.

*Comment to § 1180.01(i)*. Rather than enumerating a number of specific trades or professions that are entitled to a lien,<sup>8</sup> this statute uses generic

<sup>3</sup> The present statutes are more concerned with the "work of improvement" concept than with making the lien depend on the contractual relation of the parties. See CAL. CODE CIV. PROC. §§ 1181, 1182.

<sup>4</sup> This is a concession to the practical problems of materialmen. See Letter From Mr. Glen Behymer of the Los Angeles Bar to the *California Law Review*, April 18, 1963.

<sup>5</sup> This problem recently arose in *Theisen v. County of Los Angeles*, 54 Cal.2d 170, 352 P.2d 529, 5 Cal. Rptr. 161 (1960).

<sup>6</sup> CAL. CODE CIV. PROC. § 1182(b).

<sup>7</sup> This substantially changes present law. See CAL. CODE CIV. PROC. §§ 1181, 1182.

<sup>8</sup> See CAL. CODE CIV. PROC. § 1181; discussion in part I, A, following note 12 *supra*.

terms that include all the participants in a construction project. Occasionally it may be unclear whether a given individual is a "subcontractor," "materialman," or "mechanic." As long as he is not a contractor, however, he is bound to be one of the three if he contributes work to an improvement. The remedies of the three are the same so it makes little practical difference which specific classification is assigned to a specific individual.

- (j) *Mechanic*.—A "mechanic" is one who furnishes services for an improvement, but who is not a materialman, contractor, or subcontractor.

*Comment to § 1180.01(j)*. "Mechanic" is used in a somewhat unconventional sense solely by default; there seems to be no better word.

- (k) *Owner*.—An "owner" is a person who has an interest in real property for which an improvement is made, and who ordered the improvement to be made. "Owner" includes agents of the owner, and successors in interest taking with notice.
- (l) *Post*.—To "post" is to attach a notice to or about the improvement in a conspicuous place and in a conspicuous manner.
- (m) *Record*.—To "record" is to file for record with the county recorder of the county in which the real property is situated.
- (n) *Site of the Improvement*.—The "site of the improvement" is the real property for which the improvement is made and such space as may be required for the convenient use and occupation of the improvement.
- (o) *Subcontractor*.—A "subcontractor" is one who contracts with the contractor or another subcontractor to perform work on an improvement, but who is not a mechanic or materialman.
- (p) *Sufficient for Identification*.—A description of real property "sufficient for identification" is a description that contains the street address of the property if any such address has been given to the property by a competent public or governmental authority. If there is no street address, if the street address recited is erroneous, or if the street address is omitted, then the description is "sufficient for identification" if (1) the description is adequate to identify the property, or (2) a sufficient legal description of the property is given.

## ARTICLE II

### *Contractors' Liens*

§ 1180.02. **PURPOSE**.—It is the purpose of this chapter to provide contractors with a lien against the owner's interest in real property for the indebtedness incurred for improvements to that property. This is intended to be a comprehensive redrafting of existing statutes, but is not intended to change substantive law unless it is clear that such a change was intended.

§ 1180.03. **CONTRACTORS' LIENS**.—A contractor shall have a lien on property that he has improved. This lien is for the value of work done or materials furnished, but limited by the amount of the contract price and the price of extras. "Value of work done or materials furnished" includes a reasonable percentage for profit.

*Comment to § 1180.03*. The property interest of the owner is subject to the lien. The proposed lien is a contract lien, *i.e.*, it is predicated and dependent upon the contract between the owner and his contractor.<sup>9</sup>

§ 1180.04. **EXTENT OF LIEN**.—(a) The owner's interest in the improvement and the site of the improvement when the improvement was commenced shall be subject to

<sup>9</sup> Compare CAL. CODE CIV. PROC. §§ 1181, 1182, 1183.1, 1184.1, 1186.1(a).

the lien. A court, on rendering judgment, shall determine the geographic boundaries of the site of the improvement.

*Comment to § 1180.04(a).* It should be noted that the owner's property interest is the subject of the lien. This is consistent with the attempt to make the lien a contractual one, and would change existing law. At present, the improvement itself is subject to the lien regardless of who owns it, while only the interest in the land of the contracting owner is subject to the lien.<sup>10</sup>

- (b) The owner's interest in real property is subject to the lien when the owner orders an improvement on adjacent or adjoining property. Illustrative of this class of improvement is the construction of streets, sewers, sidewalks, or bomb shelters.

*Comment to § 1180.04(b).* Part of the § 1184.1<sup>11</sup> lien is brought under the regular lien system by this subsection, so that it is not necessary to provide for a separate lien system. This is possible because the lien is made to depend on contract. A site improvement would create a lien right under proposed § 1180.04(a).

- (c) If the owner acquires a greater interest in the property subsequent to the commencement of the improvement and the contractor understood that the owner would acquire this greater interest, then the owner's full interest in the improvement and the site of the improvement is subject to the lien. This section does not apply to additional property acquired by the owner, but only to a greater interest in the same property acquired by the owner.

*Comment to § 1180.04(c).* Additional areas acquired by the owner are not subject to the lien, but only additional interests.

- (d) A noncontracting owner is conclusively presumed to have ordered an improvement if the improvement was made with the knowledge of the owner and the owner did not post and record a notice of nonresponsibility, except that this presumption does not apply when the only interest of the owner in the property is a visible easement.

**§ 1180.05. OWNER'S NOTICE OF NONRESPONSIBILITY.**—Each owner, to prevent his interest from being subject to a lien, must post and record a notice of nonresponsibility within 10 days after he shall have obtained knowledge of the improvement. No contractors' lien can attach against that owner after the date of such recordation. A copy of the notice of nonresponsibility shall contain all of the following information:

- (1) A description of the real property affected sufficient for identification.
- (2) The name, address, and the nature of the title or interest of the owner giving notice.
- (3) The name of a purchaser under contract, if any, and the lessee, if known.
- (4) The name and address of the contractor against whom the notice is asserted.<sup>12</sup>

**§ 1180.06. CONTRACTOR'S CLAIM OF LIEN.**—(a) To perfect his contractors' lien, a contractor must record a claim of lien. This claim of lien must be recorded after the completion of the improvement and within the period of time provided in this chapter.<sup>13</sup>

<sup>10</sup> See CAL. CODE CIV. PROC. §§ 1181, 1182(a)-(b), 1183.1. For possible constitutional objections, see *English v. Olympic Auditorium, Inc.*, 217 Cal. 631, 20 P.2d 946 (1933).

<sup>11</sup> CAL. CODE CIV. PROC. § 1184.1.

<sup>12</sup> Source: CAL. CODE CIV. PROC. § 1183.1(b).

<sup>13</sup> Source: CAL. CODE CIV. PROC. § 1193.1(a).

- (b) All work done under one contract shall be considered to be a single work of improvement for purposes of perfecting a contractors' lien. Extras constitute a separate improvement, but all extras may be treated as one improvement for the purpose of perfecting a contractors' lien.

*Comment to § 1180.06(b).* This section substantially changes existing law by requiring the completion of the contract before a lien may be filed.<sup>14</sup> If the contract is for the construction of 100 houses, then all must be completed before the lien can be filed. This should create few practical problems, however, for the owner will be in contractual privity with possible lien claimants and will know the parties from whom he must secure releases to insulate individual houses from lien liability.

- (c) The claim of lien must be signed by the contractor or by his agent, and shall include all of the following information:
- (1) The name and address of the contractor.
  - (2) The name of the owner.
  - (3) A description of the interest in the property sought to be charged with the lien sufficient for identification.
  - (4) A general statement of the kind of work done or materials furnished, or both.
  - (5) A statement of the contractor's demand after deducting just credits and offsets. If the demand is against two or more owners, a statement of the demand against each owner.<sup>15</sup>

**§ 1180.07. LIEN AGAINST MULTIPLE UNITS.**—Where an improvement consists of two or more units, e.g., two houses built under one contract, and the contract does not segregate the amount due for each unit, then the contractor in his claim of lien must estimate an equitable distribution of the sum due him from each of the units based upon the proportionate amount of work done or materials furnished to each unit. The lien against the owner's interest in each unit does not extend beyond the amount designated as against other creditors having liens on that unit or on the land upon which the unit is situated.<sup>16</sup>

*Comment to § 1180.07.* In his claim of lien, the contractor must allocate the amount due of each unit when the contract involves a number of units. For example, where the contract is for the construction of 150 houses, each house is a unit and the contractor must estimate the amount due him for each house.

**§ 1180.08. LIEN AGAINST MULTIPLE PROPERTIES.**—If there is a single improvement on more than one parcel of land owned by one or more different owners, then the contractor is not required to segregate the proportion of work that entered into the improvement on each of the parcels of land. However, a trial court may, in its discretion, distribute the lien equitably between the several parcels involved.<sup>17</sup>

**§ 1180.09.** [Reserved.]

**§ 1180.10. EFFECT OF ERRORS IN CLAIM OF LIEN.**—No errors in the claim of lien shall invalidate the lien, unless

- (1) the court finds that the erroneous assertion was made with intent to defraud, or
- (2) the court finds that an innocent third party has purchased the property since the claim was filed, and the claim was so deficient that it did not put the purchaser upon further inquiry in any manner.<sup>18</sup>

<sup>14</sup> See CAL. CODE CIV. PROC. §§ 1189.1, 1195.1.

<sup>15</sup> Source: CAL. CODE CIV. PROC. § 1193.1(j).

<sup>16</sup> Source: CAL. CODE CIV. PROC. § 1194.1(a).

<sup>17</sup> Source: CAL. CODE CIV. PROC. § 1194.1(b).

<sup>18</sup> Source: CAL. CODE CIV. PROC. §§ 1193.1(k), 1196.1.

§ 1180.11. **CONTRACTOR'S TIME TO PERFECT LIEN.**—The contractor shall have 120 days after the completion of the improvement to perfect his lien, unless the fact situation is governed by another section of this chapter.<sup>19</sup>

§ 1180.12. **COMPLETION OF THE IMPROVEMENT.**—(a) Any of the following is the equivalent of the completion of an improvement:

- (1) The occupation or use of an improvement by the owner or his agent, accompanied by a cessation of work on the improvement.
- (2) The acceptance of the improvement by the owner or his agent.
- (3) After the commencement of a work of improvement, a cessation of work thereon continuously for a period of 60 calendar days.
- (4) After commencement of a work of improvement, a cessation of work thereon continuously for a period of 30 calendar days if the owner records a notice of cessation and mails a copy thereof to the contractor to be affected by the notice.<sup>20</sup>

(b) If an improvement is subject to acceptance by a governmental authority, then the completion of the improvement shall be deemed to be the date of such acceptance.<sup>21</sup>

(c) Nothing contained in this section shall extend the time for perfecting a lien when the owner files a notice of completion.

*Comment to § 1180.12.* Occasionally there may be some question as to when an improvement is completed. Sometimes this will be a simple question of fact for the trial court, such as determining whether the improvement was completed when everything was finished except for putting covers over the electrical outlets. In cases where there is likely to be some question as to the date of completion, this section sets up standards that are the equivalent of completion.

§ 1180.13. **OWNER'S NOTICE OF CESSATION.**—The notice of cessation shall be signed by the owner or his agent, and recorded. A copy shall be mailed to the contractor. It shall contain all of the following information:

- (1) The date on or about which work ceased.
- (2) A statement that the cessation from work continued until the giving of the notice.
- (3) The name and address of the owner.
- (4) The nature of the interest or estate of the owner.
- (5) The name and address of the contractor.
- (6) A description of the property sufficient for identification.<sup>22</sup>

§ 1180.14. **CONTRACTOR'S TIME TO PERFECT LIEN IF NOTICE OF COMPLETION RECORDED.**—If the owner records a notice of completion and mails a copy thereof to the contractor, then that contractor must perfect his lien within 30 calendar days after the recordation of such notice.<sup>23</sup>

§ 1180.15. **OWNER'S NOTICE OF COMPLETION.**—The owner may record a notice of completion and mail a copy thereof to the contractor. This notice must be recorded

<sup>19</sup> Source: CAL. CODE CIV. PROC. § 1193.1(c). The time period has been increased from 90 to 120 days.

<sup>20</sup> Source: CAL. CODE CIV. PROC. § 1193.1(d).

<sup>21</sup> Source: CAL. CODE CIV. PROC. § 1193.1(e).

<sup>22</sup> Source: CAL. CODE CIV. PROC. § 1193.1(h).

<sup>23</sup> Source: CAL. CODE CIV. PROC. § 1193.1(b). The time has been reduced from 60 to 30 days.

within 10 days after the improvement is completed. This notice shall contain all of the following information:

- (1) The date of completion of the improvement. The recital of an erroneous date of completion shall not affect the validity of the notice if the true date of completion is within 10 days preceding the date of filing for record.
- (2) The name and address of the owner.
- (3) The nature of the interest or estate of the owner.
- (4) The name and address of the contractor.
- (5) A description of the property sufficient for identification.<sup>24</sup>

- § 1180.16. **DURATION OF THE LIEN.**—(a) After a contractors' lien has been perfected, it expires 90 days after recordation unless proceedings to enforce it have been begun in a proper court. If credit is given and notice of the fact and terms of such credit is recorded within the 90 day period, the lien continues in force until 90 days after the expiration of the credit; but no lien continues in force by reason of any agreement to give credit for a longer time than one year from the time the work is completed.
- (b) If the proceedings to enforce the lien are not brought to trial within two years, the court in its discretion may dismiss for want of prosecution, and in all cases the dismissal of the action (unless it be stated expressly that the same is without prejudice) or a judgment rendered therein that no lien exists shall be equivalent to the cancellation and removal from the record of such lien.
- (c) No giving of credit, extension of the lien, or extension of time to enforce the lien is effective against a purchaser or encumbrancer for value and in good faith who acquired his rights more than 90 days after the recordation of the lien, unless a notice is recorded before the purchaser or encumbrancer acquired his rights.<sup>25</sup>

§ 1180.17. **PRIORITY OF LIENS.**—The liens provided for in this chapter, except as otherwise provided, are:

- (1) Preferred to any lien, mortgage, deed of trust, or other encumbrance upon the property that attached subsequent to the time when the improvement was commenced.
- (2) Preferred to any lien, mortgage, deed of trust, or other encumbrance of which the lien claimant had no notice and which was not recorded at the time the improvement was commenced.<sup>26</sup>

*Comment to § 1180.17.* A recorded security device for obligatory advances is an encumbrance of record at the date the improvement was commenced, so that subsequent advances will be prior to the contractors' lien.

§ 1180.18. [Reserved.]

§ 1180.19. **CONSOLIDATION OF ACTIONS; COSTS ALLOWED SUCCESSFUL CLAIMANTS.**—Any number of persons claiming liens against the same property may join in the same action. When separate actions are commenced the court may consolidate them. In addition to any other costs allowed by law, the court also must allow as costs to each claimant whose lien is established the money paid for recording the lien, whether the claimant is plaintiff or defendant, whether the claimants all join in one action, or whether separate actions are consolidated.<sup>27</sup>

§ 1180.20. **DEFICIENCY JUDGMENTS.**—When a contractors' lien is foreclosed but the sale of the property does not provide sufficient funds to satisfy the claim, judgment for

<sup>24</sup> Source: CAL. CODE CIV. PROC. § 1193.1(f).

<sup>25</sup> Source: CAL. CODE CIV. PROC. § 1198.1.

<sup>26</sup> Source: CAL. CODE CIV. PROC. § 1188.1.

<sup>27</sup> Source: CAL. CODE CIV. PROC. § 1199.1.

the deficiency may be entered against the party personally liable therefor in like manner and with like effect as in an action for the foreclosure of mortgages.<sup>28</sup>

**§ 1180.21. CONCURRENT PERSONAL REMEDY.**—Nothing contained in this chapter shall be construed to impair or affect the right of any contractor to maintain a personal action to recover a debt due him for an improvement. This personal action may be a separate action or may be part of a contractors' lien action. The contractor may pursue this personal remedy against the person liable therefor and may take out an attachment or execution therefor. In his affidavit to procure an attachment, the contractor need not state that his demand is not secured by a lien. Any judgment obtained by the plaintiff in such a personal action, however, shall not be construed to impair or merge any lien held by the plaintiff under this chapter. Any money collected on the personal judgment shall be allowed as credit in an action brought to enforce the contractors' lien.<sup>29</sup>

**§ 1180.22. OWNER'S BOND TO FREE PROPERTY OF LIEN.**—If an owner disputes the validity of a contractors' lien, he may record, either before or after the action to enforce the lien is commenced, a bond executed by a corporation authorized to issue surety bonds in the State of California. This bond shall be recorded. It shall be in a penal sum equal to one and one-half times the amount of the claim, or, if the lien affects more than one owner, then one and one-half times the amount allocated in the claim of lien to the owner filing the bond. The bond shall guarantee the payment of any sum that the contractor may recover on the claim together with his costs. If these requirements are met, then the owner's interest in the property shall be freed from the effect of the contractors' lien and any action brought to foreclose such lien.<sup>30</sup>

**§ 1180.23. BOND OF MORTGAGEE OR HOLDER OF DEED OF TRUST.**—The holder of any mortgage or deed of trust that is inferior to a contractors' lien may make his mortgage or deed of trust prior to the contractors' lien by doing the following:

- (1) Procuring a bond with good and sufficient sureties. Either the contractor or the owner may be the principal. The bond must comply with following requirements:
  - (i) It must be in an amount of not less than 75 per cent of the face principal amount of the mortgage or deed of trust.
  - (ii) It must refer to the mortgage or deed of trust in connection with which the bond is given.
  - (iii) It must be conditioned for the payment in full of the claims of the contractors, so as to give contractors a right to recover upon the bond in any suit to foreclose a contractors' lien, or in a separate suit brought on the bond.
- (2) Recording the bond either concurrently with or after the recordation of such mortgage or deed of trust.<sup>31</sup>

**§ 1180.24. BOND SURETIES.**—(a) The surety or sureties on any bond given pursuant to any of the provisions of this chapter shall not be exonerated or released from the obligation of the bond by any of the following:

- (1) A change, alteration, or modification in or of any contract, plans, specifications, or agreement pertaining or relating to any improvement;

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<sup>28</sup> Source: CAL. CODE CIV. PROC. § 1199.2.

<sup>29</sup> Source: CAL. CODE CIV. PROC. § 1200.

<sup>30</sup> Source: CAL. CODE CIV. PROC. § 1193.2.

<sup>31</sup> Source: CAL. CODE CIV. PROC. § 1188.2.

- (2) A change, alteration, or modification of any terms of payment or extension of the time for any payment relating or pertaining to any improvement;
  - (3) A rescission or attempted rescission of any such contract or agreement;
  - (4) A rescission or attempted rescission of the bond; or
  - (5) Any conditions in the bond attempting to limit the right of recovery.
- (b) Every bond given pursuant to this chapter will be construed most strongly against the surety and in favor of all persons for whose benefit the bond is given.
  - (c) No provision in any bond given pursuant to this chapter attempting to contract to shorten the period prescribed for the commencement of an action thereon, as prescribed by section 337 of this code, shall be valid if the provision attempts to limit the time for commencement of action thereon to a period shorter than six months from the completion of the improvement.
  - (d) In case the surety or sureties on any bond given pursuant to this chapter records the bond before the improvement is completed, then no action may be maintained thereon unless the contractor has done either of the following:
    - (1) Perfected a contractors' lien in accordance with this chapter.
    - (2) Given written notice to the surety before the expiration of the time for perfecting a contractors' lien. This shall state that the contractor had a contract with the owner for an improvement, and shall state the amount of money that is claimed to be due.

The filing of an action to foreclose a contractors' lien shall not be a condition precedent to recovery on the bond. If the bond has been recorded, any suit brought against the surety or sureties shall be filed within six months after completion of the improvement, as "completion" is defined in this chapter.

- (e) The written notice to be given to the surety or sureties may be delivered personally in the same manner as summons is served, or may be mailed. If mailed, it must be addressed:
  - (1) If to an individual surety, to his residence or place of business, if known, or
  - (2) If to an individual surety and his residence is unknown, then in care of the county clerk of the county in which said bond has been so filed, or
  - (3) To the place designated as the residence of the surety in the certificate, if any, filed by such surety or sureties as provided by section 1163 of the Civil Code, or
  - (4) If to a corporate surety, to the office or care of the agent designated by the surety in the bond as the address to which such notice shall be sent, or
  - (5) To the office or care of any officer of the surety in the State of California, or
  - (6) To the office or care of the statutory agent of the surety in the State of California.
- (f) Any bond given pursuant to any of the provisions of this chapter which otherwise fully complies therewith shall be conclusively presumed a good and sufficient bond if the surety thereon is a corporation duly authorized to issue surety bonds in this State.<sup>32</sup>

**§ 1180.25. EVIDENCE OF BOND.**—The original record of any bond, or a certified copy thereof, which has been filed for record pursuant to this chapter may be read in evidence in an action or proceeding with like effect as the original instrument, without further proof.<sup>33</sup>

**§ 1180.26. RULES OF PRACTICE.**—(a) Except as otherwise provided in this chapter, the provisions of Part 2 of this code are applicable to, and constitute the rules of practice in, the proceedings mentioned in this chapter.

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<sup>32</sup> Source: CAL. CODE CIV. PROC. § 1200.1.

<sup>33</sup> Source: CAL. CODE CIV. PROC. § 1188.2.

- (b) The provisions of Part 2 of this code, relative to new trials and appeals, except insofar as they are inconsistent with the provisions of this chapter or with rules adopted by the Judicial Council, apply to the proceedings mentioned in this chapter.<sup>34</sup>

§ 1180.27. RECORDING AND INDEXING.—The county recorder shall number, index, and preserve all contracts, plans, bonds, and other papers presented to him for filing pursuant to this chapter, and shall number, index, and transcribe into the official records in his office, in the same manner as a conveyance of land, all notices, claims of lien, and other papers filed for record with him pursuant to this chapter. He shall receive therefor the fees prescribed by the Government Code.<sup>35</sup>

SECTION 3. Article 5.5 (commencing with section 7077) is added to Chapter 9, Division 3 of the California Business and Professions Code to read as follows:

#### ARTICLE 5.5

##### *Mandatory Bonds*

§ 7077. PURPOSE.—The purpose of this article is to provide subcontractors, materialmen, and mechanics with security, in the form of a claim against a contractors bond, for the payment of services or materials provided to an improvement.

§ 7077.1. DEFINITIONS.—In this article, unless the context or subject matter otherwise requires:

- (a) *Commenced*.—An improvement is “commenced” when work is begun on an improvement.
- (b) *Contract Price*.—The “contract price” is the amount that the owner agrees to pay the contractor for an improvement.
- (c) *Contractor*.—A “contractor” is one who deals directly with the owner with regard to all or part of an improvement. The term “contractor” for the purpose of this article is synonymous with the term “builder” and, within the meaning of this article, a contractor is any person, who undertakes to or offers to undertake to or purports to have the capacity to undertake to or submits a bid to, or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, excavation or other structure, project, development or improvement, or to do any part thereof, including the erection of scaffolding or other structures or works in connection therewith. The term “contractor” includes “specialty contractor” but does not include “subcontractor.”

The term “contractor” does not include the owner of property, building or improving structures thereon, or appurtenances thereto, for the occupancy of such owner and not offered for sale, provided that the building does not contain more than three dwelling units in one of which the actual owner resides.

In all actions brought under this article, proof of the sale or offering for sale of such structures by the owner-builder within one year after completion of same is presumptive evidence that such structure was undertaken for purposes of sale.

*Comment to § 7077.1(c).* To the contractual definition used in the proposed sections of the Code of Civil Procedure has been added most of the definition of section 7026 of the Business and Professions Code. The section 7026 reference to subcontractor has been deleted, for this definition is intended to apply only to a contractor in contractual privity with the

<sup>34</sup> Source: CAL. CODE CIV. PROC. § 1201.1.

<sup>35</sup> Source: CAL. CODE CIV. PROC. § 1203.1.

owner. Where the owner is the builder, as a speculative builder using segregated contractors, then he is a "contractor" as defined herein.<sup>36</sup>

- (d) *Extras*.—"Extras" are materials or services not included in the original contract but used in the improvement at the instance of the owner.
- (e) *Furnish Materials*.—To "furnish materials" is to provide materials for the improvement or to fabricate specially materials for the improvement, pursuant to contract.
- (f) *Improve*.—To "improve" is to furnish services or materials that benefit or are intended to benefit real property. Illustrative of works that improve are building, demolishing, excavating, surveying, landscaping, and plumbing.
- (g) *Improvement*.—An "improvement" is an addition or modification that improves real property. For the purpose of this article, except as otherwise provided herein, "work of improvement" and "improvement" mean the entire structure or scheme of improvement as a whole. The extent of a "work of improvement" or "improvement" is determined by the contract with the owner.

*Comment to § 7077.1(g)*. "Work of improvement" is made to depend on each contract with the owner. As a consequence, works of improvement are commenced when each contractor begins work on his share of a construction project.

- (h) *Materialman*.—A "materialman" is one who furnishes materials for an improvement, but who is not a mechanic, contractor, or subcontractor.
- (i) *Mechanic*.—A "mechanic" is one who furnishes services for an improvement, but who is not a materialman, contractor, or subcontractor.
- (j) *Owner*.—An "owner" is a person having an interest in real property upon which an improvement is made, who ordered the improvement to be made. "Owner" includes agents of the owner, and successors in interest taking with notice.
- (k) *Post*.—To "post" is to attach a notice to or about the improvement in a conspicuous place and in a conspicuous manner.
- (l) *Record*.—To "record" is to file for record with the county recorder of the county in which the real property is situated.
- (m) *Subcontractor*.—A "subcontractor" is one who contracts with the contractor or another subcontractor to perform work on an improvement, but who is not a mechanic or materialman.
- (n) *Sufficient for Identification*.—A description of real property "sufficient for identification" is a description that contains the street address of the property if any such address has been given to the property by a competent public or governmental authority. If there is no street address, if the street address recited is erroneous, or if the street address is omitted, then the description is "sufficient for identification" if
  - (1) the description is adequate to identify the property, or
  - (2) a sufficient legal description of the property is given.

*Comment to § 7077.1*. These definitions are substantially similar to those used in the proposed sections of the Code of Civil Procedure, except as otherwise noted.

**§ 7707.2. CONTRACTORS REQUIRED TO OBTAIN BOND.**—(a) For each improvement, a contractor must obtain a bond from a surety licensed to do business in the State of California if

- (1) the contract price for the improvement is \$1,000 or more, and
- (2) the contractor contracts with or hires subcontractors, materialmen, or mechanics.

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<sup>36</sup> Source: CAL. BUS. & PROF. CODE § 7044. CAL. BUS. & PROF. CODE § 7026 defines "contractor" for the purpose of determining who is required to obtain a state contractor's license.

- (b) This bond must be obtained before work on the improvement is commenced, or reasonably contemporaneous thereto. Bonds obtained after the improvement is commenced shall be of the same effect to the beneficiaries thereof as bonds obtained before the improvement is commenced.
- (c) This bond shall be payable to all subcontractors, materialmen, or mechanics who provide work or materials for the improvement and who comply with the requirements of this chapter.
- (d) This bond shall be in the following amounts:
  - (1) If the contract price does not exceed \$50,000, then for the full amount of the contract price.
  - (2) If the contract price is greater than \$50,000 but does not exceed \$200,000, then for 75 per cent of the contract price.
  - (3) If the contract price is greater than \$200,000 but does not exceed \$1,000,000, then for 50 per cent of the contract price.
  - (4) If the contract price is greater than \$1,000,000 but does not exceed \$5,000,000, then for 40 per cent of the contract price.
  - (5) If the contract price is greater than \$5,000,000, then for \$2,500,000.
- (e) An additional bond must be obtained when the price of extras exceeds the contract price by 10 per cent. The surety or sureties of this bond shall be liable with the surety or sureties of the original bond in the ratio that the amount of the bond for extras bears to the total amount of the bond for the contract.<sup>37</sup>
- (f) A bond meeting the requirements of this chapter must be obtained for every improvement of whatever contract price in any case wherein the improvement is only a part of a larger or major operation in which the operation is divided into contracts of amounts less than \$1,000 for the purpose of evading this article.
- (g) The State Contractors License Board may take adequate disciplinary measures if
  - (1) a bond has not been obtained,
  - (2) a bond is required by this chapter, and
  - (3) a contractor performs work or permits work to be performed on an improvement.

*Comment to § 7077.2.* The most significant change in this proposed revision of mechanics' lien law is apparent in this section. No longer are liens given to subcontractors, materialmen, and mechanics. Instead, the contractor is required to bond himself for the benefit of these classes, and they may proceed against the bond.

A bond is mandatory for each work of improvement undertaken by a contractor if two conditions are met: (1) The contract price for the improvement exceeds \$1,000, and (2) the contractor contracts with or hires subcontractors, materialmen, or mechanics. The \$1,000 figure is somewhat arbitrary, but was chosen because it is the amount used by the Public Works Bonding Act.<sup>38</sup> For jobs under \$1,000, the subcontractors, mechanics, and materialmen are in effect given a lien on the property since they are permitted to force the contractor to foreclose a contractors' lien. A bond is not required unless the contractor in turn contracts with subcontractors, materialmen, or mechanics. Since the definitions of these classes are so broad, however, it is likely that few contractors will be able to do much without becoming involved with one of these persons. For example, if the contractor purchases lumber for an improvement, then he has entered into a contract with a materialman.

The bond must be obtained before work under the contract is commenced, or reasonably contemporaneous thereto. Even if the bond is not procured in time, the subcontractors, materialmen, and mechanics are protected even though the contractor may be subject to disciplinary action by the State Contractors License Board. The section lists the amounts in

<sup>37</sup> Source: State Bar Report, G-1, 5.

<sup>38</sup> CAL. GOV'T CODE § 4200.

which the bonds must be obtained. Additional bonding protection must be acquired when the price of extras exceeds the original contract price by 10 per cent.

§ 7077.3. **CERTIFICATION.**—(a) The surety providing the contractors bond shall provide a certificate of financial responsibility for each improvement undertaken. This certificate shall include all of the following information:

- (1) The name of the contractor that is bonded.
- (2) A description of the site of the improvement sufficient for identification.
- (3) A statement that the surety has bonded the contractor in accordance with Section 7077.2 of this chapter.
- (4) A certificate number that may be used for reference to the improvement.
- (5) The name of the surety and the address to which all communications concerning the improvement may be directed.

(b) The certificate shall be

- (1) Recorded, and
- (2) Posted.

*Comment to § 7077.3.* The surety who provides the contractors bond is required to supply the contractor with a certificate of financial responsibility. Since each improvement is bonded separately, there is a separate certificate for each improvement for which a bond is required. The certificate must be numbered so that the improvement can be identified by reference to the number. In addition, the certificate must contain the other information required by the section. The certificate has to be recorded at the county recorder's office and a copy must be posted at the job site.

§ 7077.4. **CONDITIONS TO RECOVERY ON BOND.**—(a) In order to recover on a bond provided by this chapter, a subcontractor, mechanic, or materialman who contracts with reference to an improvement must file a memorandum with the surety before, or reasonably contemporaneous with, performing work.<sup>39</sup>

(b) This memorandum shall contain the following information:

- (1) The certificate number of the improvement.
- (2) The name and address of the person filing.
- (3) The name and address of the person or persons with whom he has his contract.
- (4) The amount of his contract or a reasonable estimate of the amount.
- (5) The nature of the work or materials to be furnished.

(c) This memorandum shall be filed with the surety at the address specified in the surety's certificate of financial responsibility. The memorandum may be delivered by personal service, by registered mail, or by certified mail.

*Comment to § 7077.4.* Although the bonding provisions are an attempt to provide an adequate security to subcontractors, materialmen, and mechanics, these classes must perform certain conditions precedent before they are entitled to recover on the contractors bond. These parties must give notice to the surety that they may have a claim against the bond at some future date so that the surety may control his potential liability. This notice must

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<sup>39</sup> One practicing lawyer expressed the opinion that this requirement is "completely unrealistic, particularly with reference to laborers. No such rigid notice is required under the Miller Act which apparently functions properly throughout the United States." Letter From Mr. Richard C. Dinkelspiel of the San Francisco Bar to the *California Law Review*, April 24, 1963. The requirement was inserted to provide the sureties with information on the progress of the construction project, so that they would know their potential liability from time to time. It is important to sureties that they know the extent of potential claims; this permits them to pay claims without requiring their being reduced to judgment, absent other factors that would make it advisable for the surety to require that the claim be reduced to judgment. Probably most subcontractors, materialmen, and mechanics would find it less onerous to mail a postcard—even by certified mail—than to reduce a claim to judgment.

be given by a memorandum setting forth the information required by the statute, and must be given at the approximate time that work or materials are furnished. The memorandum must refer to the improvement by its certificate number for identification purposes, must give the name of the parties involved in the contract, must disclose an educated guess as to the amount of the contract price if the exact sum is not known, and must describe the general work or materials to be furnished. Printed postcards could be used for giving this information.

**§ 7077.5. BOND CONDITION TO PERFORMANCE OF CONTRACT.**—No subcontractor, contractor, materialman, or mechanic shall be required to perform according to the terms of a contract with a contractor unless the contractor is bonded in accordance with the provisions of this chapter.

*Comment to § 7077.5.* Subcontractors, materialmen, and mechanics are relieved of their duty to perform under contracts with the contractor if the contractor does not bond himself in accordance with the provisions of this chapter. Since the bonds are required by law, it is reasonable to assume that these classes would have contemplated the protection of a bond when contracting, but this section alleviates any possible ambiguity.

**§ 7077.6. PRIORITY.**—Claims of subcontractors, materialmen, and mechanics against bonds provided for in this chapter are all of equal priority.

*Comment to § 7077.6.* Subcontractors, materialmen, and mechanics are on a parity as to their claims against a contractor's bond regardless of the time when they contributed goods or services. It is assumed that releases will be required when payments are made to potential claimants. These releases then will be forwarded to the surety. The surety thus will have a running tabulation of his possible liability under the bond. Furthermore, the surety will be able to pay claimants without the necessity of the claim being reduced to judgment, since he can be reasonably certain of his potential liability.

**§ 7077.7. STATUTE OF LIMITATIONS.**—Suits may be brought under the bond provided for in this article within six months after the completion of the improvement.<sup>40</sup>

**§ 7077.8. REMEDIES WHERE BOND NOT REQUIRED.**—(a) If a bond is not required by this article for an improvement, any unpaid subcontractor, materialman, or mechanic who performs work on such improvement may do the following:

- (1) Obtain an injunction to require the contractor to perfect a contractor's lien.
  - (2) Join as a party in any foreclosure action brought by the contractor against the owner in which the contractor is foreclosing his contractor's lien.
  - (3) Institute a foreclosure action against the owner to foreclose the contractor's lien, joining the contractor as a party defendant, in the event that the contractor refuses to foreclose his contractor's lien.
- (b) The court in the foreclosure proceeding shall provide that such proceeds from the action be paid to the claimant as are necessary to satisfy the amount due him. If there are insufficient proceeds to satisfy fully all claims, the court shall distribute pro rata such proceeds.

*Comment to § 7077.8.* Since there is no special protection for subcontractors, materialmen, or mechanics when the contract price is under \$1,000, it is necessary to provide specially for this group of contracts unless these classes are to be left to ordinary creditors remedies. In such a case, this section provides that subcontractors, materialmen, and mechanics shall in effect have a lien on the property. The protected classes may require the contractor to perfect a contractor's lien, may join in the action foreclosing

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<sup>40</sup> Source: State Bar Report, G-1, 9.

the lien, and may institute a foreclosure action if the contractor refuses to do so. The court in the foreclosure proceeding will provide that the claimant be paid, or provide for a pro rata distribution if there are insufficient funds.

**§ 7077.9. SURETY MAY DEPOSIT MONEY IN COURT.**—If a surety contests the validity or the amount of any claim or claims asserted by subcontractors, materialmen, or mechanics, the surety may deposit sufficient money to cover the disputed claims into court in an interpleader action and join the claimants as parties. This section does not deprive the surety of any other remedies or rights that it might have at law or equity, but merely makes clear that disputed claims may be litigated in an interpleader action.

**§ 7078. CERTIFICATION BY SURETY.**—If the surety certifies but does not bond an improvement, then the surety shall be liable for all claim notices filed in the same manner as if the contractor were properly bonded.

**§ 7078.1. DIRECT ACTION.**—A subcontractor, materialman, or mechanic may proceed directly against the surety without first suing the contractor if the subcontractor, mechanic, or materialman includes with his complaint an affidavit by the contractor, his trustee in bankruptcy, or other person entitled to act for him that the contractor is unwilling or unable to pay.

**§ 7078.2. JOINDER OF CLAIMS.**—Any number of persons suing a surety on claims arising out of claim notices filed under the same certification may join in the same action. When separate actions are commenced the court may consolidate them. In addition to any other costs allowed by law, the court, in its discretion, may allow reasonable attorney's fees.

**§ 7078.3. CUMULATIVE REMEDIES.**—Nothing in this article shall be construed to impair the right of a subcontractor, materialman, or mechanic to pursue any action independent of a bond claim against either the contractor or the surety or both.

**§ 7078.4. SURETIES; CODE OF CIVIL PROCEDURE APPLICABLE.**—A surety providing a contractor's bond shall be subject to Section 1180.24(a), (b), (c), and (e) of the Code of Civil Procedure.

**§ 7078.5. ARTICLE INAPPLICABLE TO GOVERNMENT CONTRACTS.**—This article does not apply to contracts with the State of California or any County, City, or other political subdivision thereof, including school, utility, improvement, drainage, irrigation, and other similar districts within the State.<sup>41</sup>

**SECTION 4.** Section 1 of this act shall be effective one year following the date of enactment of this act, except that it shall not apply to improvements then commenced, as "improvements" is defined within section 2 of this act. Sections 2 and 3 of this act shall be effective one year following the date of enactment of this act. Section 5 of this act is effective immediately upon enactment.

*Comment to Section 4:* If a comprehensive revision were enacted, it would be necessary to operate under two systems of liens until all new work had begun while the new statutes were in effect. This is advisable to avoid constitutional problems of destroying vested property interests. Consequently, work in progress when the statute was adopted would continue to be governed by the old system. Work commenced after adoption of the statute would be governed by the new statute.

**SECTION 5.** The Secretary of State is directed to reprint this act and to make copies available free of charge to all those involved in the building industry, to send a copy thereof to each licensed contractor, and diligently to seek to familiarize the members of the construction industry with its provisions.

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<sup>41</sup> Source: State Bar Report, G-1, 10.

## APPENDIX B

## TIME SCHEDULE ON CLAIMS OF MATERIALMEN

Prepared by Richard C. Dinkelspiel of the San Francisco Bar.

## I. Private Jobs

## A. Claim of Lien on Private Jobs

1. Notice of Claim (CAL. CODE CIV. PROC. § 1193)
  - a. Must be given at least 15 days before filing claim of lien.
  - b. Must be given to owner *and* general contractor.  
*Note:* Statute does not define owner. Give notice to everyone having interest in the property.
  - c. Must be given by personal delivery or by registered or certified mail.  
*Note:* Address must be that shown in building permit. Check building permit.
  - d. Need *not* be given by those under direct contract with the owner or those performing actual labor for wages.
2. Recording of Claim (CAL. CODE CIV. PROC. § 1193.1)
  - a. Minimum periods
    - (1) General contractor cannot record before completion of his contract.
    - (2) All others cannot record before they have ceased to perform labor or furnish materials.
  - b. Maximum period (if no notice of completion recorded):  
All persons have 90 days after "completion" to record, *except as provided in c and d below.*
  - c. If valid notice of completion recorded (within 10 days of actual completion):
    - (1) General contractor must record within 60 days thereafter.
    - (2) All others must record within 30 days thereafter.
  - d. If there is cessation of labor (and no notice of completion):
    - (1) If there is cessation of labor for 60 days, all persons have an additional 90 days to record.
    - (2) If there is cessation of labor for 30 days *and* owner records notice of cessation,
      - (a) General contractor must record within 60 days after notice.
      - (b) All others must record within 30 days after notice.

## B. Notice to Withhold on Private Jobs (CAL. CODE CIV. PROC. § 1190.1)

1. Must be given within the period required for recording claims of lien but *may* be given even before performance commences.
2. Must be given to owner.
3. Must be given by personal delivery or by registered mail.
4. Cannot be given by general contractor.

## C. Law Suit Involving Private Job

1. On Claim of Lien (CAL. CODE CIV. PROC. § 1198.1)
  - a. Suit to foreclose lien must be filed within 90 days after recording claim of lien.
  - b. Time to file suit may be extended for period not to exceed one year when credit extended to owner.
  - c. Case should be brought to trial within 2 years.
  - d. Notice of pendency of action should be recorded after suit is filed.

2. On Notice to Withhold (CAL. CODE CIV. PROC. § 1197.1)
  - a. Cannot be filed before the time has expired for recording claims of lien.
  - b. Must be filed within 90 days after time has expired for filing claims of lien.
  - c. Case should be brought to trial within 2 years.
  - d. Notice of pendency of action *must* be given or filed within 5 days after filing suit to same persons and in same manner as required with respect to the notice of claim.
3. On Bonds (CAL. CODE CIV. PROC. § 1200.1)
  - a. Maximum period (if bond and contract *not* recorded); same as action on any written contract; suit must be filed within 4 years from breach of contract.
  - b. If bond *and* contract recorded before work commences, then bond may limit time to file suit to 6 months from date of completion.
  - c. If bond recorded before completion, then must give notice of claim to surety before filing suit by *either*:
    - (1) Recording claim of lien, *or*
    - (2) Giving written notice to surety within time for recording claim by personal delivery or registered mail.

## II. California Public Works

### A. Notice to Withhold

1. Notice to Claim (CAL. GOV'T CODE § 4210)
  - a. Must be given within 90 days from the date on which last of labor or materials were furnished by claimant.
  - b. Must be given to public agency *and* to general contractor.
  - c. Must be given by personal delivery or by registered or certified mail.
  - d. Need not be given by those having direct contractual relationship with contractor or by those performing actual labor for wages.
2. Filing of Notice
  - a. Public Works Generally (School Districts, etc.) (CAL. CODE CIV. PROC. § 1192.1)
    - (1) Cannot be filed before furnishing the last of labor and materials by claimant.
    - (2) Must be filed within the period otherwise available for recording claims of lien. (See I, A, 2 above.)
    - (3) Time for filing notice may be shortened if public body:
      - (a) Records notice of completion within 10 days after actual completion, *or*
      - (b) Records notice of cessation of labor within 10 days after a 30-day cessation of labor.
  - b. State Contract Act, *i.e.*, Under State Dep't of Public Works (CAL. CODE CIV. PROC. § 1192.1(b); CAL. GOV'T CODE §§ 14250, 14371-77). Cannot be filed before furnishing the last of labor and materials by claimant.
    - (a) 90 days after acceptance of project, if no notice of completion recorded, *or*
    - (b) 30 days after recording notice of completion if notice recorded within 10 days of acceptance.
3. Suit on Notice (CAL. CODE CIV. PROC. § 1197.1)
  - a. Cannot be filed before the time otherwise available for recording claims of lien has expired. (See I, A, 2 above.)
  - b. Must be filed within 90 days after time has expired for recording claims of lien. (See I, A, 2 above.)

- c. Case should be brought to trial within 2 years.
- d. Notice of pendency of action must be recorded within 5 days after filing suit.

#### B. Suit on Bond on Public Job

1. Notice of Claim (CAL. GOV'T CODE § 4209)
  - a. Must be given within 90 days from the date on which last of labor or materials were furnished by claimant.
  - b. Must be given to general contractor.
  - c. Must be given by personal delivery or by registered or certified mail.
  - d. Need *not* be given by those having direct contractual relationship with contractor or by those performing actual labor for wages.
2. Suit on Bond—Must Bring Suit:
  - (1) Within 6 months after period in which verified claims may be filed under CAL. CODE CIV. PROC. § 1192.1 on:
    - (a) Bonds under Public Works Act. Attorneys' fees provided. Can sue at any time after furnishing materials. CAL. GOV'T CODE §§ 4200-03, 11 CAL. ADM. CODE § 57.
    - (b) Bonds under Street Improvement Act of 1911. CAL. STREETS & H'WAYS CODE §§ 5290-97. Bonds under Street Improvement Act of 1913. CAL. STREETS & H'WAYS CODE §§ 7210-18.
    - (c) Bond on sewer district jobs. CAL. HEALTH & SAFETY CODE §§ 1520-21.
  - (2) Within 6 months after filing claim on bond on recreation and harbor district job. CAL. HARB. & NAV. CODE §§ 6576-79.
  - (3) Query as to time suit must be commenced on bond given under "State Contract Act." CAL. GOV'T CODE § 14373 provides that such bond "shall contain all other provisions required by law." Safest policy: Sue within 6 months after *completion* in accordance with CAL. CODE CIV. PROC. § 1200.1(c), (d), rather than using later dates mentioned in 2 above.

### III. Federal Public Works

- A. Miller Act (40 U.S.C. § 270a-e (1958)).
  1. Notice of Claim
    - a. Not required of persons dealing directly with general contractor.
    - b. Others must give written notice of claim
      - (1) To general contractor
      - (2) By registered mail
      - (3) Within 90 days after furnishing last of labor or materials.
  2. Suit on Bond
    - a. Cannot be filed before 90 days from furnishing last of labor or materials.
    - b. Must be filed within one year after furnishing last of labor or materials.
    - c. Must be filed in the federal district court and in the name of the United States of America for the use and benefit of the claimant.
- B. Capehart Act (42 U.S.C. § 1594 (1958)).
  1. Notice of Claim: Act refers to Miller Act but simple notice requirements of Miller Act probably not sufficient because of bond presently required by government.
  2. Under Present FHA Form Bond, Notice of Claim:
    - a. Is required of every one except the general contractor.
    - b. Notice must be given to any *two* of the following: general contractor, Delaware corporations, lending institution, or surety.

- c. Notice must be given by personal delivery or by registered mail, or by filing a mechanics' lien.
  - d. Notice must be given within 90 days after furnishing last of labor or materials, or within the period for the giving of first notice of a mechanics' lien, whichever is longer.
  - e. Best policy: Give notice *and* record lien.
3. Suit on Bond
- a. Cannot be filed before 90 days from furnishing last of labor or materials, or before the period for the giving of first notice of a mechanics' lien, whichever is longer.
  - b. Must be filed within one year after general contractor ceases work on the contract.

### APPENDIX C

#### SUMMARY OF PRIVATE STOP NOTICES

California Code of Civil Procedure sections 1190.1 and 1197.1 are summarized below by their respective subparts.<sup>42</sup>

§ 1190.1(a): Authorizes all persons entitled to claim a lien under §§ 1181 or 1184.1 (except the original contractor), to file a notice with the owner, to the effect that they have furnished labor or material, or have agreed to do so. The notice must be given within the time when liens could be filed against the property, and, in general terms, must say:

- a. The kind of materials or labor;
- b. The name of the person to whom, or for whom the labor or materials were furnished;
- c. The value of the labor or material furnished and the value of the labor or materials agreed to be furnished.

The lien claimant is required to give such notice upon written demand by the owner, and failure to comply with the written demand will deprive the claimant of any lien rights.

§ 1190.1(b): The notice must be verified by the claimant, or his agent, and may be given by delivering it to the owner, by leaving it at the owner's residence or business if left with someone in charge, or by delivery to the owner's architect, if there be one.

No notice is invalid by reason of any defect in form so long as it is sufficient to inform the owner of the substantial matters provided in subparagraph (a).

§ 1190.1(c): Upon the notice being given, there is a duty imposed to withhold sufficient money from the contractor or from any person acting under his authority to answer the claim and any lien which may be filed by the claimant.

If a statutory labor and material bond has been furnished under § 1185.1 and recorded in the Recorder's office, then there is no duty to withhold, but the owner may withhold funds, at the owner's option. If the contractor disputes the claim, he may file an affidavit setting forth his objections to the claim, such affidavit to be filed, in duplicate, with ". . . the department head, board, commission or officer thereof . . .", but, in its present form, the section makes no provision for service of such affidavit upon a private owner.

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<sup>42</sup> Reprinted from State Bar Report, J-2.

- § 1190.1(d): If the money withheld after service of the notice is not sufficient to pay all of the demands received from claimants filing notices, the funds withheld are to be distributed pro rata among the persons entitled to share therein who have filed notices. No priority results from an earlier filing.
- § 1190.1(e): Any person giving a false notice forfeits all rights to the money withheld and forfeits any lien rights, if the notice is either wilfully false, or wilfully includes work or materials not performed or furnished.
- § 1190.1(l): If the work of improvement is financed in whole or in part from a building loan, the stop notice may be filed with the mortgagee or beneficiary of the trust deed, or the successor in interest of either, or to the escrow holder or other party holding funds. The notice must meet the requirements of subparagraph (a). Upon the giving of such notice, the recipient may withhold funds, and, if a bond in the amount of one and one-quarter times the amount of the claim is furnished, then the recipient must withhold funds to answer the claim and any lien.
- The bond furnished must be in a penal sum equal to one and one-quarter times the amount of the claim, to indemnify the defendant for all costs and damages which may be sustained by reason of the equitable garnishment effected by the notice and claim, in the event the defendant recovers judgment in any action brought upon the claim or lien that may be filed therefor.
- No assignment by the owner, or by the contractor of construction loan funds, whether made before or after the filing of the claim has any priority over the claim.
- § 1190.1(i): If the claim filed with the holder of funds is disputed, the contractor, subcontractor, or any person against whom the claim is asserted, may furnish a bond in the amount of one and one-quarter times the claim, to guarantee its payment up to such penal amount, and the funds are then released.
- § 1190.1(j): Subsections (h) and (i) have no application to improvements when a statutory labor and material bond under § 1185.1 has been furnished and recorded in the Recorder's office prior to filing of the stop notice.
- § 1190.1(l): Service of the verified stop notice by registered mail is equivalent to personal service.
- § 1190.1(m): If the person holding the funds objects to the sufficiency of the sureties on the bond referred to in subdivision (h), notice of objection must be given to the claimant within 20 days, and the claimant must, within 10 days, furnish a corporate surety bond executed by a surety licensed to write bonds in the State of California. Failure to do so will authorize the person holding the funds to disregard the notice and release the funds.
- § 1197.1: No action to enforce any claim on a private stop notice may be commenced prior to expiration of the time for filing claims, and any such action must be commenced not later than 90 days after the time for filing claims has expired. If no action is commenced within such 90-day period, the funds are not to be withheld; if the suit is not prosecuted to judgment within 2 years, the Court may dismiss the action, and if the action be dismissed (unless the dismissal is without prejudice) the funds are released and paid to the person to whom they are due.
- Notice of commencement of the proceedings must be given or filed within 5 days. Joinder of claimants is authorized, and the owner is given the right to implead claimants.