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By John J. Hopkins*

THE LAW of mechanics' liens is confusing. Even counsel for construction lenders, builders, materialmen, title insurers, and others who are confronted daily with problems in this area frequently battle the uncertainties and ambiguities in the law. Attention here will be focused upon selected priority of lien problems which have particularly troubled attorneys. While some answers will be suggested, the purpose of the article is to pinpoint these problems in the hope that the Governor's Advisory Committee on Mechanics' Liens and various other groups now studying the lien law may find satisfactory answers. Their task will not be an easy one, for with problems of priority there will inevitably be sharp divisions of opinion.

Lien Problems Related to Commencement of Work

What is Commencement of Work?

Mechanics' liens attach at the commencement of the improvement for which the lien claimant has done his work or furnished his material —not when the claim of lien is recorded, and not when the claimant actually performed his work or delivered his material.[1] It is therefore important for priority purposes to ascertain what constitutes commencement of work. The generally recognized test 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."[2]

This "visible to the eye" test, however, is not satisfactory where the operations in question are preparatory to actual construction, such as clearing or leveling the building site, installing a water meter, marking the improvement location with stakes, or removing or demolishing buildings. Besides, it is common for materials to be used on a project to be delivered to adjoining property. Title insurance companies have

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1 CAL. CODE CIV. PROC. § 1188.1.

2 Arthur B. Siri, Inc. v. Bridges, 189 Cal. App. 2d 599, 602, 11 Cal. Rptr. 322, 324 (1961) (quoting PHILLIPS, MECHANICS' LIENS 387 (3d ed. 1893)).

even used mine detectors to be certain that no material was lurking in the construction site weeds. But at least there was *some* standard, and by careful inspection a degree of protection could be afforded insurers and lenders. A possible big break came early in 1961 in *Nolte v. Smith*[3] where it was held that survey work of a type not previously considered sufficient to constitute the commencement of work was sufficient. Although not a priority case, *Nolte* may indicate a departure from the traditional test, since the visibility of certain pipe markers placed by the claimant was not even considered as a factor in the result. The court cites with apparent favor a Minnesota decision upholding the lien of an architect in a case where *no* physical change had been affected upon the land subjected to the lien.[4]

In proper cases, architects are given a lien for "performing labor upon or bestowing skill or other necessary services on . . . the construction, alteration, addition to, or repair, either in whole or in part, of, any building, structure, or other work of improvement . . . ."[5] Is the start of such architectural services commencement of work for determining the priority of the liens for work performed and materials used later in completing the project? In *Design Associates Inc. v. Welch*[6] the court refused to allow a lien for architectural services of a "pre-preliminary" nature, whereas in *Nolte* the planned project was never commenced. However, the court does cite as "apt" the language of *Fiske v. School Dist.*:[7] " 'Perhaps, if the building be actually constructed, the drawing of plans then enters into the construction . . . .' "[8] Also, in upholding the trial court's determination that the architectural work involved did not create a lien, the court does state that "it is a question of fact whether improvement *has been commenced.*"[9] Does the court mean that certain architectural services might constitute commencement of work for lien priority purposes, especially where there is no visible evidence on the property and the project planned was actually constructed? At least two cases awaiting trial in San Mateo and Santa Clara Counties are priority cases (unlike *Design Associates*) and present the question whether laborers and material-

[3] 189 Cal. App. 2d 140, 11 Cal. Rptr. 261 (1961).

[4] Lamoreaux v. Anderschi, 128 Minn. 261, 150 N.W. 908 (1915).

[5] CAL. CODE CIV. PROC. § 1181.

[6] 224 A.C.A. 209, 36 Cal. Rptr. 341 (1964).

[7] 58 Neb. 163, 38 N.W. 392 (1899).

[8] 224 A.C.A. at 217, 36 Cal. Rptr. at 346.

[9] *Id.* at 217, 36 Cal. Rptr. at 346 (quoting Arthur B. Siri, Inc. v. Bridges, 189 Cal. App. 2d 599, 601, 11 Cal. Rptr. 322, 324 (1961). (Emphasis added.)

men can "ride the coattails" of the project architect for purposes of priority.[10]

It seems probable that the great favor shown lien claimants by the courts of this State will lead inevitably to more decisions broadening the concept of commencement of work for lien purposes. It is unreasonable for hidden work to afford later mechanics priority over the lender who records his deed of trust or mortgage before the start of any apparent work upon the property but after unseen work has commenced. A possible solution would be a statute providing that the liens of architects, engineers, and any others doing non-visible work would be subordinate to any mortgage or deed of trust recorded without actual notice of the work, unless a special notice of commencement was recorded. It is doubtful that non-visible work should ever constitute commencement as to all subsequent work on the property, even if the special notice is given. If the commencement notice for surveyors', architects', or engineers' work was held commencement of work on the improvement itself, financing would be difficult or impossible to obtain after completion of the preliminary work. True, the subsequent liens could be bonded pursuant to section 1188.2 of the Code of Civil Procedure, but the expense and practical unavailability of such bonds makes them a doubtful answer to the problem.[11]

Subdivisions and Problems of Commencement

Under section 1195.1 of the Code of Civil Procedure is the start of the first house in a subdivision the commencement of all the subsequent houses for priority of lien purposes? The section provides that each residential unit shall be considered a separate work of improvement and that the time for filing claims of lien against each unit shall run from the time of completion of that unit. Section 1195.1 deals only with the filing of claims of lien, with no specific provision as to commencement for lien purposes. Ogden suggests that "the definition was intended to make each residential structure a separate work of improvement solely for completion purposes."[12] This interpretation is strengthened by the refusal of the legislature to insert suggested language which dealt specifically with commencement.[13] There are no cases on the problem because lenders and title insurers guarantee

[10] For ethical reasons these cases cannot be cited by name at present.

[11] *But see* A-1 Door Co. v. Fresno Guar. Sav. & Loan Ass'n, 61 A.C. 670, 40 Cal. Rptr. 85 (1964), which indicates that a bond is a practical way to avoid problems of stop notice claims.

[12] OGDEN, CALIFORNIA REAL PROPERTY 624 (1954).

[13] 2 CAL. ASSEMBLY JOUR. 2710 (reg. sess. 1954).

priority by recording encumbrances before the work on the first house begins. Where "model homes" have been built, title insurers require a bond to be filed or wait until the period for filing claims has run before insuring the priority of a loan given to finance the construction of the balance of the tract.

Where the off-site work[14] on a subdivision is done pursuant to a separate contract, section 1189.1(a) of the Code of Civil Procedure provides that the commencement of such work, although it ordinarily precedes the start of the first house, does not constitute commencement of the construction phase of the project. However, if such off-site work is not done pursuant to a separate contract, its start would appear to be a general commencement of work done on the site or builder's land for priority of lien purposes under section 1188.1.[15]

A related problem concerns the subdivision project under one general contract which is completed in several units. Assuming that section 1195.1 makes the start of the first house commencement, for lien purposes, of each succeeding house, it is probable that the commencement of the first house in the first of several units would be regarded as commencement of each succeeding house in any unit of the same subdivision. This is especially true if there is a single general contract for all of the units. The problem is more difficult where the financing of the various units is by different lenders—a common occurrence. Must the lender of unit *B* wait ninety days after the last notice of completion has been filed for unit *A* before he may safely record his encumbrance? He would be well advised to wait. Commencement of the houses in unit *A* may well have inured to the benefit of unit *B* mechanics insofar as the determination of their priority versus the loan under section 1188.1. But even waiting ninety days may not be adequate protection, since the notice of completion respecting that unit may not have been proper.

All of this comes to a head when the subdivider wishes to commence unit *B* as rapidly as possible after *A*. The prudent lender who finances the second unit will require suitable title insurance before recording his mortgage or deed of trust. The title company, as a condition precedent to the issuance of its policy, will insist that the requisite period elapse after recordation of proper completion notice of unit *A*, or that a bond under section 1188.2 be supplied. The delay may endanger the success of the project, especially since construction crews will not be able to move on to the second unit.

[14] See CAL. CODE CIV. PROC. § 1184.1 (refers to a lien for civic improvements made at the request of the site owner).

[15] See OGDEN, CALIFORNIA REAL PROPERTY 624 (1954).

Commencement and the Problem of On-Site Work Done by the Off-Site Contractor

Suppose that a contractor is engaged under separate contract to do off-site work of the type mentioned in Code of Civil Procedure section 1184.1 upon a subdivision project. Suppose further that the subdivider is aware of the presence of earth moving equipment needed for the off-site work and persuades the contractor to do certain on-site jobs, such as blading out driveways for prospective building sites, leveling and rolling a pad for the tract office and lumber stockpile, digging holes for the slab foundations, or digging away earthen banks to create patio space for some of the building sites. The possibilities are endless.

These minor on-site jobs should be done while all the appropriate equipment of the off-site contractor is on the scene. However, a problem may arise later in determining the priorities of the construction money lender, whose deed of trust was recorded prior to the commencement of the work under a separate building construction contract, and an unpaid mechanic, whose lien arose out of work done during the house construction. The unpaid mechanic argues that the date the house construction commences, for priority of lien purposes, is the date the off-site improvement begins, or at least the date when the off-site contractor commenced the "extras" previously mentioned. This date would obviously precede the recordation of the house construction loan and would, if adopted, avoid the effect of section 1189.1(a), which provides that the commencement of improvements of the type mentioned in section 1184.1 shall not constitute the commencement of the erection of houses undertaken pursuant to a separate contract. There is no answer to this particular problem in the cases.[16]

It has been suggested that the statute be amended to provide that on-site work merely incidental to the off-site improvement undertaken under separate contract should not in any event constitute commencement of the later on-site building improvement.[17] However, it is difficult to imagine how the courts would construe "merely incidental" in the amended section. Suppose the incidental work is paid for by the

[16] See generally PROCEEDINGS OF THE 1961 CALIFORNIA LAND TITLE ASSOCIATION CONVENTION 92.

[17] STATE BAR OF CALIFORNIA, FINAL REPORT OF COMMITTEE TO STUDY 1958 CONFERENCE RESOLUTION No. 70 (dealing with mechanics' lien laws) at 119-45, Sept. 11, 1962 (unpublished report in University of California Law School Library, Berkeley) [hereinafter cited as STATE BAR REPORT].

subdivider or the "extras," though incidental to the off-site project, are relatively extensive. As the law now stands, a lender could reasonably believe he is recording his encumbrance before the start of the on-site job he is financing and think the "extras" previously done by the off-site contractor are off-site work under the separate contract.

Purchase Money Encumbrances Versus Mechanics' Liens

As to priority against mechanics' liens, should there be a distinction between purchase money encumbrances and ordinary lenders' trust deeds or mortgages? This question is occasioned by section 2898 of the Civil Code, which provides that a purchase money encumbrance "has priority over all other liens created against the purchaser, subject to the operation of the recording laws." On the other hand, Code of Civil Procedure section 1188.1 provides that mechanics' liens are preferred to any mortgage or deed of trust that (1) attached after the commencement of work, or (2) attached before the commencement of work and was unrecorded and unknown to the lien claimant at the time of commencement.

If a purchase money mortgage is recorded prior to the commencement of work, ordinarily there is no question of priority. However, a priority question is raised if the lien claimant proves that the mortgagee and mortgagor were joint venturers[18] or that the mortgagee is estopped from asserting his priority.[19] But suppose work commenced, with no lien claims recorded, at the mortgagor's request even before he acquired title and recorded the purchase money mortgage. This situation could arise if a purchaser enters into possession under a contract of sale prior to the execution of a purchase money encumbrance in favor of the seller. Ogden indicates that here the mechanics' lien claimant may have priority, but there is no clear answer in the cases.[20]

If the seller had actual or constructive notice of the start of the work before the recordation of the purchase money encumbrance, it would seem that his purchase money mortgage lien might be superior to the mechanic's lien if a timely notice of non-responsibility pursuant to section 1183.1 of the Code of Civil Procedure is recorded.[21]

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[18] See, *e.g.*, City Lumber Co. v. Brown, 46 Cal. App. 603, 189 Pac. 830 (1920).

[19] See, *e.g.*, Rheem Mfg. Co. v. United States, 57 Cal. 2d 623, 371 P.2d 578, 21 Cal. Rptr. 802 (1962) (claimant failed to establish estoppel).

[20] OGDEN, CALIFORNIA REAL PROPERTY 620 (1954).

[21] Avery v. Clark, 87 Cal. 619, 25 Pac. 919 (1891). In order to avoid responsibility for mechanics' liens, a non-contracting owner must file a notice within ten days after he obtains knowledge of the construction.

In the case of a seller with notice, even the non-responsibility notice would probably not afford priority to his purchase money encumbrance recorded after the commencement of work known to him.

More difficult is the question of the seller who has no notice of the commencement of work and whose purchase money encumbrance is recorded after such commencement. There is no reasonable basis for making a distinction between purchase money and ordinary loan encumbrances—at least as to their relative priority against mechanics' liens.

Why the Special Priority Rule of Code of Civil Procedure Section 1189.1(b)?

Section 1189.1(b) provides that the liens arising out of off-site improvements are preferred to (1) mortgages and deeds of trust attaching after the commencement of the off-site work, (2) mortgages and deeds of trust attaching before the commencement of such work if unrecorded and not known to the claimant, *and also* (3) mortgages and deeds of trust given for "the sole or primary purpose" of financing such off-site improvements which are recorded *prior* to the commencement of the off-site improvement, unless there is a lender's control agreement or bond as detailed in the section. In effect, section 1189.1(b) reiterates the general rule of section 1188.1 on the relative priority of mechanics' liens against mortgages and trust deeds, and then creates a special rule of priority for mortgages and trust deeds that secure the financing of off-site improvements.

No good reason can be found for this special rule. Its elimination would put an end to various problems including the determination of whether a loan is "for the sole or primary purpose of financing" an off-site improvement.[22] Had the legislature not included the words "or primary" in the section, this problem would be less difficult. As it stands, "how high is up?" can as easily be answered. Some attorneys have questioned the constitutionality of the section because it can operate to give a preference to off-site claimants by affording them priority even over deeds of trust or mortgages recorded *before* the commencement of their work.[23] Since loans are often made to finance off-site as well as on-site work, title insurers cannot be certain that the lenders insured by them against mechanics' liens have priority even if their encumbrance was recorded before the commencement of the on-site work, for the loan might have been made for the primary purpose of financing the off-site work.

[22] *But see* Comment, 51 CALIF. L. REV. 351 n.144 (1963).

[23] STATE BAR REPORT 119-45.

The special rule of section 1189.1(b) also seems wrong because lenders who record their mortgages or deeds of trust to secure loans for on-site work attain priority over liens for subsequently commenced work of all kinds without any special lender's agreement or bond.[24] Why should the lender who finances only the off-site improvement have any greater burden to protect his position of priority?

The special priority problem of section 1189.1(b) would be eliminated if any of the current proposals for compulsory labor and material bonds were adopted.[25] In view of the strong opposition to compulsory bond proposals,[26] however, the likelihood of their early adoption appears remote.

Conclusion

This article should serve to illustrate the need for revision of the present law. The author has found the largest number of problems in the area of priorities. It is significant, however, that commentators on other areas of the lien laws often indicate that theirs are the areas of greatest immediate concern. Small wonder then, that the work of the committees now studying all phases of the mechanics' lien law is of such interest and importance to the Bar.

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[24] OGDEN, CALIFORNIA REAL PROPERTY 616-17 (1954).

[25] A model draft statute for contractors' liens and materials bonds is appended to Comment, 51 CALIF. L. REV. 351, 369-83 (1963).

[26] See A-1 Door Co. v. Fresno Guar. Sav. & Loan Ass'n, 61 A.C. 670, 40 Cal. Rptr. 85 (1964).