The Forgotten Man of Mechanics' Lien Laws--The Homeowner

George R. Nock
COMMENTS

THE "FORGOTTEN MAN" OF MECHANICS' LIEN LAWS—THE HOMEOWNER

By George R. Nock*

Of all the law's victims, perhaps none is more deserving of sympathy than the honest homeowner who is cheated of his property, courtesy of the mechanics' lien laws. And let us not fail to shed a tear for the lien claimant, whom the lien laws were designed to protect at the homeowner's expense, and who, ironically, often finds that his rights are illusory. It is the purpose of this comment to explore the problems raised by this paradox and to evaluate some proposed solutions. Special consideration will be given the proposal most frequently and enthusiastically advanced—compulsory bonding of contractors on private works. A suggested compulsory bonding statute drafted by a committee of the California State Bar will be analyzed in detail.¹

The California constitution gives "mechanics, materialmen, artisans, and laborers of every class . . . a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished . . . ."² The legislature has extended lien rights to other classes of persons, including contractors and subcontractors.³ At the same time, the legislature, recognizing that lending institutions would finance construction only if their loans were secured by trust deeds which were preferred to other encumbrances, has provided the money lenders with a reliable method of insuring that their trust deeds will be preferred to mechanics' liens.⁴ Under present practices, federal home-loan guarantees have resulted in construction loans being made for nearly the full value of the completed structure.⁵ The net result is that mechanics' liens are, in perhaps the majority of instances,⁶ junior to one or more trust deeds.

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¹ State Bar of California, Final Report of Committee to Study 1958 Conference Resolution No. 70, at 89-94 (dealing with mechanics' lien laws), Sept. 11, 1982 (unpublished report in University of California Law School Library, Berkeley) [hereinafter cited as STATE BAR REPORT].

² Cal. Const. art. XX, § 15.

³ Cal. Code Civ. Proc. § 1181. The list also includes "artisans, architects, registered engineers, licensed land surveyors, builders, teamsters and draymen . . . ."

⁴ Cal. Code Civ. Proc. § 1188.1. Under this section, the trust deed will be prior if recorded before commencement of work.

⁵ Senate Judicial Committee for Interim, 1953-1955, Third Progress Report to the Legislature 87 [hereinafter cited as Third Progress Report].

⁶ Id. at 99.
After these deeds are foreclosed, there is little or nothing left for the lien claimants. The homeowner faces an even more serious problem. Mechanics’ liens are not limited to the amount of the contract price agreed upon by the owner and contractor for the construction work. They are limited only by the reasonable value of the work done or materials furnished by each claimant (although they cannot exceed the amount of the contract price agreed upon by the claimant and the person with whom he contracted).7 Thus, the owner may pay the contractor the full price of the structure and, if the contractor does not pay his laborers, subcontractors, or materialmen (or his subcontractors do not pay the persons with whom they have contracted) the owner may find that the unpaid claimants have filed liens against his property. He must satisfy these claims out of his own pocket or suffer the loss of his property upon foreclosure of the liens. The owner becomes an involuntary guarantor that the contractor and those working under him will fulfill their obligations to all those who have contributed to the work of improvement. Recognizing this as unconscionable, the legislature has provided the owner with a means of limiting his aggregate liability to the contract price. If he requires the contractor to procure a bond and records it, along with the contract, the court, “where it would be equitable so to do,” must restrict judgments on liens in a foreclosure action to the amount which the owner owes the contractor, and give judgment against the surety on the bond for the difference between this amount and the amount of the lien claims.8 The bond must meet certain requirements—it must be given by “good and sufficient sureties,” must be for an amount not less than half the contract price, and must inure to the benefit of those entitled to mechanics’ liens.9 It should be noted that the bond protects the owner fully, even if it is insufficient in amount to cover all the claims of lienors.10

The problem arises from the fact that the owner, in most cases, does not take out such a bond, and therefore does not protect himself from the risks of “double payment.” He does not do so, because he is usually totally unaware of the risks confronting him until it is too late.

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8 If a proper bond has been filed and recorded, along with the contract, before work has commenced, “the court must, where it would be equitable so to do, restrict the recovery under such liens to an aggregate amount equal to the amount found to be due from the owner to the contractor and render judgment against the contractor and his sureties on said bond for any deficiency or difference there may remain between said amount so found to be due to the contractor and the whole amount found to be due to claimants for such labor or materials or both.” Cal. Code Civ. Proc. § 1185.1(c).
10 The statute specifically declares a legislative intent to enable the owner to limit his liability to the amount of the contract price, by procuring a proper bond. Cal. Code Civ. Proc. § 1185.1(d).
Many, if not most, homeowners have never heard of mechanics' liens. Very few know about the double payment problem and how to protect themselves from it. Most of those who do know are talked out of their right to require the contractor to procure a bond, either by the contractor or by some "disinterested" third party, such as a money lender, who, acting at the contractor's instance, advises against requiring a bond.11 Suspecting nothing, the homeowner does not bother to secure the advice of counsel. If the contractor fails before satisfying his debts incurred on the project, the homeowner may lose his entire interest in the property which was to have been his "dream house." The life savings of an unsuspecting homeowner may ultimately turn up on the list of liabilities in the contractor's bankruptcy petition.

**NATURE OF COMPULSORY BONDING PLANS**

The gravity of the difficulties confronting claimants and homeowners has begotten almost as many proposed solutions as there are persons concerned about the problem. Perhaps the one most frequently advanced is a statutory requirement—aimed at protecting both lienors and owners—that contractors must, on all or some private jobs, file a bond meeting the present statutory requirements.12 Such a statute would, wherever it was applied, protect the homeowner by insuring that his liability would be limited to the contract price. It would protect the lien claimants by giving them a right of action against the surety on the bond in case they were not paid, in addition to the uncertain lien rights which they now enjoy. Such a bond is now required on all construction contracts (exceeding 2,500 dollars) let by the State of California.13

Compulsory bonding plans (with one exception to be discussed later) would not alter existing mechanics' liens statutes, but would merely supplement them. However, they would, where applicable, render mechanics' liens obsolete by providing a simpler and more effective remedy.

Since not all contracts should be required to be accompanied by a bond—the practical difficulties of securing and recording a bond for the installation of a stove would be enormous in relation to the amounts involved—the question arises as to which contracts should be

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11 It has been asserted that when a contractor hears that an owner is thinking about requiring a bond, he makes it clear to the lender that the latter should advise the owner against the bond. The lender, wishing to retain the contractor's business, assures the owner that the contractor is reliable and a bond unnecessary. Third Progress Report 88.

12 At present, the bond is optional with the owner. Cal. Code Civ. Proc. § 1185.1.

exempt. One proposal,\textsuperscript{14} which may be called the “comprehensive plan,” would require the bond if the contract exceeded some small amount, such as \$1,000\textsuperscript{16} or \$2,500 dollars. Another proposal, which may be referred to as the “limited plan,” would require only contracts exceeding a much larger sum to be accompanied by a bond.

The latter approach was taken by the State Bar of California in a suggested statute which it drafted.\textsuperscript{16} That statute, hereinafter referred to as State Bar Statute,\textsuperscript{17} would require all licensed contractors to furnish the owner a corporate surety bond in the amount of the contract price where the total value of the work to be done exceeded \$25,000 dollars. The bond would be a faithful performance and labor and material bond (\textit{i.e.}, it would guarantee to the owner that the contractor would faithfully perform his contract, and to the lienors that they would be paid if the contractor defaulted), and at least fifty per cent of it would have to inure to the benefit of potential lienors. A new bond, or a rider to the original one, would have to be obtained if the contract price were increased ten per cent or more by change orders. In lieu of the corporate surety bond, the contractor could furnish a bond executed by two personal sureties, provided they qualified before the Contractors' State License Board. In order to qualify, each surety would have to be a California resident and householder and have a net worth, apart from property exempt from execution, of the amount of the bond.\textsuperscript{18} A copy of the bond would have to be mailed to the Board; failure to mail it would extend the limitation period for suits on the bond, which is normally six months, to two years, and would be grounds for disciplinary action against the contractor by the Board.\textsuperscript{19} The Board would then make copies of the bond available on request to beneficiaries of the bond. It would not be necessary to file a mechanics' lien before suing on the bond unless the surety had requested the claimant to do so, in writing, and in time for the claimant to comply with the statutory requirements for filing. The

\textsuperscript{14} This proposal does not appear to have been put forward in precisely the form in which it is discussed herein. This form is convenient for discussion, since it combines the common features of several similar proposals.

\textsuperscript{15} The amount formerly used in \textit{Cal. Gov't Code} § 4200.

\textsuperscript{16} \textit{STATE BAR REPORT} 89-94.

\textsuperscript{17} The title given in the \textit{STATE BAR REPORT} is “Specimen Compulsory Bonding Law Private Works.”

\textsuperscript{18} \textit{STATE BAR REPORT} 90.

\textsuperscript{19} This is the only provision made in the State Bar Statute for sanctions for non-compliance, and the context leaves it unclear whether failure to furnish the bond, or merely to mail the bond, is to be grounds for disciplinary action. Unless the sanctions for noncompliance were clearly stated, the statute would be ineffectual.
statute would apply to all contracts between an owner and a prime contractor\textsuperscript{20} for private construction or alteration work.

CONSTITUTIONALITY OF COMPULSORY BONDING

Before attempting an evaluation of these proposals, it might be wise to consider whether compulsory bonding would be constitutional. The question is not altogether clear, the California Supreme Court having ruled both ways, depending on the nature of the statute before it.\textsuperscript{21} No statute like those contemplated has ever been considered by that court.

The constitutionality of mandatory bonding statutes has a checkered history. It was originally settled law\textsuperscript{22} that, notwithstanding the wording of the constitution,\textsuperscript{23} mechanics' liens were restricted to the amount of the contract price—that is, the amount found due and owing from the owner to the contractor at the time the liens were filed. An attempt by the legislature to remove this limitation was declared invalid.\textsuperscript{24} Then in 1885 the legislature provided\textsuperscript{25} that contracts which did not follow a prescribed form, designed to protect lienors, were void, and left the property subject to unlimited mechanics' liens. The constitutionality of this provision was apparently never questioned, but it "did not work well in practical operation"\textsuperscript{26} because the complexities of the required contract provisions gave rise to frequent disputes as to whether the statutory requirements had been met. A later statute\textsuperscript{27} providing for a compulsory bond in the amount of twenty-five percent of the contract price was held unconstitutional in \textit{Gibbs v. Tally}.\textsuperscript{28} The effect of noncompliance with this statute was to render the owner personally liable in damages to persons injured as a result of failure to file a valid bond. The chief grounds for holding the statute unconstitutional were that it sought to make the owner liable for a debt he did not owe and that it violated the constitutional guarantees of the right of "acquiring, possessing, and protecting property,"\textsuperscript{29} including the right of freedom to contract respecting that property. The court also

\textsuperscript{20}It is unclear from the wording whether the statute would apply in the case of an owner who uses segregated contractors and supervises the work himself.
\textsuperscript{21}Roystone Co. v. Darling, 171 Cal. 526, 154 Pac. 15 (1915) (constitutional); \textit{Gibbs v. Tally}, 133 Cal. 373, 65 Pac. 970 (1901) (unconstitutional).
\textsuperscript{22}Renton v. Conley, 49 Cal. 185 (1874).
\textsuperscript{23}The liens are given "for the value of such labor done and material furnished . . . ." \textit{CAL. CONST. art. XX, § 15.}
\textsuperscript{25}Cal. Stat. 1885, ch. 152, § 1, at 143.
\textsuperscript{26}Roystone Co. v. Darling, 171 Cal. 526, 533, 154 Pac. 15, 18 (1915).
\textsuperscript{27}Cal. Stat. 1893, ch. 171, § 1, at 202.
\textsuperscript{28}133 Cal. 373, 65 Pac. 970 (1901).
\textsuperscript{29}CAL. CONST. art. I, § 1.
asserted that the statute was a violation of due process, under the federal constitution.\textsuperscript{30}

In 1911 the legislature hit upon a successful and constitutionally acceptable method of protecting lienors, while at the same time permitting the owner to limit his liability to the contract price. The provision,\textsuperscript{31} which remains the law today,\textsuperscript{32} removed the limitation of lien liability, but permitted the owner to restore it by procuring, or causing to be procured, the requisite bond. This was sustained as constitutional in the leading case of \textit{Roystone Co. v. Darling}.\textsuperscript{33} The court, in sustaining the statute, declined to express an opinion as to whether it would be constitutional to require a bond to be taken out other than as a condition of limiting the owner's lien liability.

No flat prediction as to the constitutionality of compulsory bonding statutes can safely be made. The question would be much clearer had the court in \textit{Roystone Co.} seen fit to overrule \textit{Gibbs}, but it did not do so. An educated guess, however, can be hazarded. The constitutionality of a compulsory bonding law would probably depend on the nature of the sanctions imposed for noncompliance. If the statute sought to impose personal (as opposed to lien) liability on the owner if no bond were filed, it would be unconstitutional under the holding in \textit{Gibbs}. If, however, the contractor alone were to pay the penalty (such as revocation or suspension of his license) for failure to procure a bond, the statute would probably be justified as a reasonable regulation of the contracting business, comparable to the license bonds required to be posted by the holders of certain occupations, including some contractors.\textsuperscript{34}

The argument that compulsory bonding statutes would restrict the owner's freedom of contract by requiring him to absorb all or part of the cost of the bond premium, whatever its merit, would probably not be sympathetically received by the courts. This is because it would likely be raised by a party adverse to the owner, such as a contractor,

\textsuperscript{30} Doubt was cast upon the validity of this assertion by a dictum in \textit{Hartford Acc. & Indem. Co. v. N. O. Nelson Mfg. Co.}, 291 U.S. 352, 359 (1934), and it was flatly contradicted in \textit{Hollenbeck-Bush Planing Mill Co. v. Amweg}, 177 Cal. 159, 170 Pac. 148 (1917).

\textsuperscript{31} Cal. Stat. 1911, ch. 681, § 1, at 1313.


\textsuperscript{33} 171 Cal. 526, 154 Pac. 15 (1915). The case gives a thorough history of the problem.

\textsuperscript{34} \textit{E.g.}, \textit{Cal. Bus. & Prof. Code} § 7071.5 requires a bond of $3,000 to $10,000 as a condition precedent to the issuance or reissuance of a contractor's license to anyone against whom disciplinary action has ever been taken. Section 7071.9 requires a bond of $1,000 as a prerequisite to the issuance or renewal of a license in all cases. These bonds are for the benefit of lienors and others who may be damaged by the contractor's professional misbehavior.
or a surety trying to avoid a bond the surety had written on the ground that the statute requiring it was unconstitutional.\(^{35}\)

THE EXTENT OF THE PROBLEMS

Other objections to compulsory bonding must be sought outside the constitution. Before considering them, it would be helpful to try to determine the extent of the problems. If these problems are theoretical only, no statutory solution may be necessary. It will be convenient to place those who suffer under the present mechanics' liens scheme into three general categories: laborers, other lien claimants (chiefly including materialmen and subcontractors, but not contractors), and homeowners. The extent of the problems confronting each category—and the need for their solution—will be considered separately.

Laborers

Laborers are presently afforded numerous protections outside of the lien laws. In California they are commonly represented by unions. There are laws which require that they be paid at least twice a month; failure to pay wages on time subjects the employer to civil penalties.\(^{36}\) They are also given preference over the general creditors of their employers in case of the employer's insolvency, or when such a creditor seeks to garnish or attach the employer's assets.\(^{37}\) Their unions normally require them to stop work on a job if a payday is missed or a paycheck bounces.\(^{38}\) Finally, they are permitted to assign their wage claims to the State Division of Labor Law Enforcement, which prosecutes them vigorously, acting as a sort of collection attorney for the employee, without fee.\(^{39}\) The Labor Commissioner is even permitted to take assignments of unperfected mechanics' liens,\(^{40}\) even though the inchoate right to file such liens is not otherwise assignable.\(^{41}\) In spite of all this protection, some wage losses on the part of construction workers do occur. Precise figures are not presently available,\(^{42}\) but William E. Fleck, Supervising Deputy Labor Commissioner, estimates that losses on verified wage claims are thirty per cent on private construction jobs

\(^{35}\) See also Shaughnessy v. American Sur. Co., 138 Cal. 543, 69 Pac. 250, aff'd on rehearing, 71 Pac. 701 (1903), which held that a bond given pursuant to an unconstitutional mandatory-bonding statute was void as a statutory bond and was not good as a common law bond.


\(^{37}\) CAL. CODE CIV. PROC. §§ 1204, 1206.

\(^{38}\) Confidential Telephone Interview With Labor Union Official in San Francisco, Aug. 18, 1964.

\(^{39}\) CAL. LABOR CODE §§ 96-99.

\(^{40}\) CAL. LABOR CODE §§ 96, 97.

\(^{41}\) Mills v. La Verne Land Co., 97 Cal. 254, 32 Pac. 169 (1893).

\(^{42}\) The Division of Labor Law Enforcement is now compiling such figures. Interview With Mr. William E. Fleck, Supervising Deputy Labor Commissioner, in San Francisco, Aug. 19, 1964.
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(AS OPPOSED TO ABOUT FIVE PER CENT IN PUBLIC CONSTRUCTION WORK, WHICH IS BONDED). Still, the dollar volume of such losses could not be too great, as the total wage losses in all jobs, not merely those involving private construction, scarcely exceeded 500,000 dollars in fiscal 1963-1964. Since most construction wage losses can be attributed either to failure on the part of employees to present their claims in time to file mechanics' liens, or to priorities of trust deeds over liens duly filed, the problem could be largely alleviated by compulsory bonding. However, although the extent of the problem confronting laborers is uncertain, it is probably so small as not to warrant a solution that would impose serious hardships on others. This is especially true in light of the fact that few laborers actually sustain serious losses; a laborer who continues to work after his wages are in default has only himself to blame for further losses.

Subcontractors and Materialmen

Subcontractors and materialmen, on the other hand, are given no statutory protection apart from the mechanics' lien laws. Are they entitled to any additional protection? It is submitted that they are not. They are businessmen, and presumably able to take care of themselves. Unlike laborers, they can reasonably be expected to take the trouble to consult a lawyer or otherwise acquaint themselves with the laws relating to their particular businesses. They can be expected, before extending credit, to determine whether any liens they might file will be junior to other encumbrances—such information may be obtained by examinations of the public records and of the jobsite, which will tell him whether work has been commenced. If a subcontractor or materialman is not satisfied with a contractor's signature and does not find sufficient security in the lien laws, he should demand additional security; if he does not get it, he should refuse to enter into a contract. Such a refusal of business demands a certain amount of courage, but no more than is required of businessmen outside the construction industry, who are given no statutory security. No entirely convincing reason has been advanced for even the present preferred status of subcontractors and materialmen relative to other classes of businessmen.

43 This estimate is confined to claims made to the Division of Labor Law Enforcement. Interview With Mr. William E. Fleck, Supervising Deputy Labor Commissioner, in San Francisco, Aug. 19, 1964.
44 Figures obtained from the files of the Division of Labor Law Enforcement, San Francisco.
46 Only encumbrances which are recorded or of which the lienor has actual knowledge before work has been commenced will be preferred to mechanics' liens. CAL. CODE CIV. PROC. § 1188.1.
47 This assertion will be supported at length infra.
Therefore, there seems no sound reason for affording them additional protection, except as an incidental consequence of measures aimed at alleviating the problems of those who have a respectable claim to greater protection.

Owners

The homeowner, however, is in an entirely different position; he can suffer grave financial losses as the result of another's dishonesty or financial irresponsibility without being at all aware of the risks he faces. He is accustomed to purchasing personalty on credit, and realizes that his automobile or television set can be repossessed only if he should breach his installment sales contract. He has no reason to believe that he can lose his entire interest in his land and the house he is building even though he complies strictly with every fine-print term of his construction contract. It is true that he has available adequate legal means to protect himself, but it is equally true that he does not utilize these means. He is blissfully unaware of the problem, and his contractor, reluctant to take out a bond, will not enlighten him. He could, of course, protect himself if he took the trouble to consult a competent attorney before letting the contract, but the fact is that very few people think of seeing a lawyer until they are in trouble. The easiest thing to do would be to shrug the matter off with the observation that anyone who makes large investments without consulting a lawyer deserves whatever he gets; but this is a rather harsh attitude.

The homeowner is also entitled to special consideration from the legislature because he alone, among those affected by legislation in the field of mechanics' liens, is not organized, and thus not represented by lobbyists in Sacramento. Unanswered is the question of how frequent and how extensive are the homeowner's losses. There is little evidence on the point. Apparently, the problem first received public attention in the early 1950's, when a number of swimming-pool contractors failed, leaving over 300 owners in Los Angeles County alone with liens on their property, amounting to as much as 250 per cent of the contract price on each pool. The Los Angeles County Grand Jury viewed the situation with considerable alarm, and recommended legislative action along certain lines (not, incidentally, including compulsory bonding). Apparently,
no such widespread losses have occurred since, and such losses as have occurred do not seem to have received public attention. There are some estimates, by interested individuals, indicating that losses are small and infrequent. \(^2\) Statistics on the number and dollar value of mechanics' liens filed\(^3\) are not helpful, as there is no way of determining how many are filed by contractors themselves when the owner defaults, and how many of those not filed by the contractor are satisfied by the contractor at no cost to the owner.\(^4\) Figures compiled by the Contractors' State License Board concerning the number and kind of verified statutory violations by contractors are more helpful. In fiscal 1963-1964, there were 69 cases of abandonment of projects,\(^5\) 23 cases of diversion of funds (which is most likely to result in loss to the owner),\(^6\) 84 cases involving withholding of funds (owed to potential lienors) by the contractor,\(^7\) and 227 cases of bankruptcy.\(^8\) But for myriad reasons,\(^9\) even these figures are far from conclusive in determining the

invoices within ten days after performance of labor or sale of materials, noting on the invoices that if they were unpaid after thirty days, mechanics' liens would be filed. It was also recommended that lenders be required to retain at least twenty per cent of the loan funds until expiration of the period for the filing of liens.

\(^2\) These estimates are usually made by persons who would suffer some loss or inconvenience if a compulsory bonding statute or some other solution were enacted. In Fourth Progress Report 108, it was said that on only about one occasion in three months (in Santa Clara County) is a homeowner required to pay more than the contract price. A representative of materialmen asserted that members of his association file lien claims on only about one out of every 200 jobs on which they furnish materials. Id. at 38. Double payment was asserted to be a "bad situation," but "not sufficiently widespread" to warrant measures which would substantially increase construction costs. Third Progress Report 107.

\(^3\) E.g., in 1953, 5,796 mechanics' liens, totalling $4,443,000, were filed in Los Angeles County. Third Progress Report 103.

\(^4\) The contractor is not only personally liable for the claims of those with whom he has contracted, but must defend at his own expense any action brought to foreclose a lien, apparently including liens filed by persons with whom the contractor was not in privity, such as the materialman of a subcontractor. Amounts recovered on lien claims may be deducted by the owner from payments due the contractor. CAL. CODE CIV. PROCV. § 1186.1. However, if the owner has settled with the contractor in full, he can recover from the contractor only the amount of lien claims "for which the contractor was originally the party liable." This section does not appear to have been construed, so it is unclear whether the owner could recover on claims, which he had satisfied, filed by persons with whom the contractor had no privity.

\(^5\) Violation of CAL. BUS. & PROF. CODE § 7107.

\(^6\) Violation of CAL. BUS. & PROF. CODE § 7108.

\(^7\) Violation of CAL. BUS. & PROF. CODE § 7120.

\(^8\) Violation of CAL. BUS. & PROF. CODE § 7113.5. The term "bankruptcy" is used generically. The section also forbids any other settlement of claims with creditors generally for less than their full value.

\(^9\) E.g., a contractor may abandon a project before being paid; funds diverted or withheld may be restored by the contractor after complaint to the Board is made; creditors of a bankrupt contractor may not file timely claims of lien; the same contractor is often found in violation of several statutes on the same job.
number of losses by homeowners, and not at all helpful in determining the amount of such losses. The result is that until adequate public records are available, it will be impossible to determine the frequency and amount of homeowners' losses.

The overall conclusion is that all three classes have problems, and those of the homeowner cry out most strongly for solution. But the extent of these problems is presently unknown; it may be very great, or very small. This should be borne in mind in evaluating the proposals for compulsory bonding.

EFFECT OF COMPULSORY BONDING

"Comprehensive Plan"

What would be the effect of a compulsory bonding statute? Let us consider first the "comprehensive plan" (applicable to contracts exceeding 1,000 or 2,500 dollars). By affording the lien claimant a right of action against a financially responsible surety and insuring that the homeowner would have to pay for his property once only, such a statute would obviously solve the most serious problems. It would not afford protection on jobs involving small sums, but losses on such jobs would likely be small. Since revocation or suspension of license is the most appropriate sanction for noncompliance, the statute would apply only to licensed contractors, who represent an unknown percentage of all contractors. The enforcement problems are not to be underestimated. There would be some minor beneficial effects.

60 These are the amounts formerly and presently used in connection with compulsory bonding in public works contracts. CAL. GOV'T CODE § 4200.

61 Because some swimming pools are advertised for less than $2,500, swimming pool contractors would not be covered by a bonding statute unless the $1,000 limitation were used. Since swimming pool contractors have, by one instance of mass failure, shown themselves to be questionable risks, it would seem wise to cover them. See note 50 supra and accompanying text.

62 It has been estimated that only twenty-five per cent of the contractors in Orange County are licensed. THIRD PROGRESS REPORT 78. Since it is a misdemeanor to act as a contractor without a license, CAL. BUS. & PROF. CODE § 7028, this estimate, if accurate, indicates that enforcement of this section may be somewhat lax.

63 At present, the Contractors' State License Board apparently enforces the law only in response to complaints of violation. Any action which poses a threat to lienors or owners is already grounds for disciplinary action, and this type of enforcement has not been effective in solving the problem. It would seem, therefore, that the effectiveness of a bonding statute would depend on tighter enforcement procedures. Adequate enforcement would require an agent of the Board to examine every building permit issued in the State and determine, if a bond were required for the particular contract, whether the contractor was in fact bonded (and licensed). The legislature should consider what additional appropriations the Board would need in order to carry out this task.

64 For instance, the contractor would have the benefit of the surety's expert advice, and might thus avoid jobs he is not prepared to handle.
Unfortunately such legislation would not be without its negative effects. These effects might be very minor—or they might be quite injurious, not only to the construction industry, but to the entire economy of the State. The consequences are largely unpredictable; they would depend primarily on the behavior of the surety industry in response to the legislation.

One of the arguments in favor of compulsory bonding is that it would have a salutary effect on the construction industry by eliminating those contractors who are dishonest, incompetent, insolvent, and therefore unbondable. Unfortunately, there is no reason to believe that such contractors would be the only ones put out of business. Bonding companies risk enormous losses on each bond in relation to the very small premium they receive. Consequently, they are forced to impose extremely high standards on those seeking to bond themselves. To secure a corporate surety bond, a contractor must show himself to be experienced, thoroughly honest, and competent. In addition, he must exhibit a high degree of financial responsibility. The result is that many honest, competent, and solvent contractors, while presenting a very slight risk that they will not be able to undertake successfully a given job, nonetheless present a risk greater than the sureties are willing to accept—the premium is simply not worth it. It has been estimated that as many as 30,000 of the 38,735 licensed general contractors could not get bonds. There is no reason to believe that more than a small fraction of these unbondable contractors present a clear and present danger of inflicting losses on homeowners or lien claimants. The “comprehensive plan” could result in their being forced out of business, or into subcontracting or small alteration jobs. But the consequences would not necessarily stop there. Most of the small, unbondable contractors probably specialize in homebuilding. Their sudden elimination could result in a severe shortage of contractors willing and able to build individual homes. If the larger, bondable contractors, who tend to specialize in heavier types of construction, were reluctant, because of lack of experience in home construction, to fill this gap, the result could be a temporary dislocation of the economy. This economic dislocation would be the result of a severe dip in housing starts, with

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65 Most bonds are actually faithful performance bonds, to which a labor and material bond is appended at no extra cost. The cost of such a bond is normally one percent of the contract price on the first $100,000, with some diminution in the rate as the size of the bond increases. Interview With Mr. Lee Cutler of Marsh and McLennan, Brokers, in San Francisco, Aug. 19, 1964.


67 Figure (for fiscal 1963-1964) obtained from the files of the Contractors’ State License Board, San Francisco.

68 Interview With Mr. Byrne E. Davis of Marsh and McLennan, Brokers, in San Francisco, Aug. 19, 1964.
consequent unemployment and business failures not only among contractors, but also among subcontractors, materialmen, and the workers employed by all of them. And the homeowner would not get his house built, for want of someone to build it. Since experience normally is required of a contractor before he can get a corporate surety bond, the contracting field would be closed to new entrants—except for well-capitalized corporations, and individuals with wealthy friends or relatives, who would be willing to write personal surety bonds to give a young man his start.

If the events discussed above were to occur, the political repercussions would almost certainly lead to remedial legislation. For instance, the legislature might create a state bonding agency, which would bond most of the otherwise unbondable contractors. Assuming that the sureties are right in their refusal to bond most contractors, such an agency would either have to charge outsize premiums, thus adding materially to construction costs, or operate at a deficit, which would be made up out of general revenues. We would then be treated to the spectacle of taxpayers subsidizing contractors.

Of course, the above might not happen at all. The sureties, in response to the pressures on them to bond small contractors, might well re-evaluate their bonding requirements and liberalize them sufficiently to accommodate small, honest, and competent contractors. Or they might develop an assigned-risk plan. Of course, if they did these things contrary to sound actuarial practice, they might go bankrupt themselves. And any legislation tending to promote bankruptcies among surety companies hardly promotes business stability. It is even barely possible that the sureties might develop a plan, similar to that used among casualty insurers, regulating their premium rates according to the risk potential of the individual contractor. But any resultant increase in premium rates would probably be borne, in whole or in part, by the homeowner.

In sum, the social and economic consequences of comprehensive compulsory bonding legislation are unpredictable—they may be very great, or very small. There is no good reason to believe that they would not be serious. At the same time the extent of the problem sought to be solved is largely uncertain. Consequently, comprehensive compulsory bonding legislation could have the effect of alleviating a very great problem at very small social cost—or of alleviating a very minor problem at very great cost. It is submitted that the risk is too great to take. Such legislation cannot be recommended at least until such time as

69 Under an assigned risk plan, each surety would bond an allotted portion of the poor risks among the contractors, perhaps at higher rates. The system works in automobile liability insurance, but the sureties insist it would not be applicable to contractors' bonds. Confidential Telephone Interview With an Executive of a Large Surety Company, in San Francisco, Aug. 23, 1964.
the extent of the problem can be measured with some precision, and proves to be acute.

State Bar Statute

The dangers outlined above were no doubt recognized by the framers of the State Bar Statute, which would apply only to contracts exceeding 25,000 dollars. This limitation removes many of the objections to compulsory bonding—and effectively emasculates the statute. The proposal would have only very minor negative social consequences at most. Some deserving small contractors would be unable to graduate to larger jobs; if a few contractors would be forced out of business. But the statute would not solve the problem to any real extent, as it would not offer protection to those who need it most. It would not effectively protect laborers, as wage losses occur predominantly on small jobs. It would not protect the ordinary homeowner, as most homes still cost less than 25,000 dollars to build, exclusive of land. It would protect the owner of a relatively expensive home, although he is more likely to be in the habit of seeking the advice of counsel before making large investments, and would thus be able to protect himself.

The State Bar Statute, as written, is reported as “acceptable” to the surety industry. It is not difficult to see why. Most large construction contracts are accompanied by bonds, as the large corporations and wealthy individuals who let them are aware of the law and take the proper steps to protect themselves. But many are not. If the contractor is a large construction firm with unquestioned credit, the owner may regard the bond as unnecessary and elect to spare himself

70 If a contractor normally constructed homes costing less than $25,000, and then sought a bond on a larger job, the surety would be more reluctant to bond him than if it had received bond premiums from the smaller jobs and had been able to observe the contractor’s performance on them. Interview With Mr. Byrne E. Davis of Marsh and McLennan, Brokers, in San Francisco, Aug. 19, 1964.


72 For the nation as a whole, the average construction cost of new one-family housing units started in 1963 was $14,975. Statistical Abstract of the United States 751 (1964). Similar figures are apparently unavailable for California. Statistics in the file of the San Francisco Central Permit Bureau indicate that the San Francisco figure slightly exceeds $25,000. One report on construction costs in the San Francisco Bay Area gives the cost of a hypothetical “Medium Dwelling” as $14,917, and that of a “Good Dwelling” as $26,487 (not including the value of the lot). Bay Area Real Estate Report 22, 24. (Copyright 1964).

73 State Bar Report 87.

74 It is apparently customary, in the case of major private construction, to require bonds if the contract is let by competitive bidding, but to dispense with the bond if the contract is negotiated, and the contractor’s credit is satisfactory to the owner. Interview With Mr. Byrne E. Davis of Marsh and McLennan, Brokers, in San Francisco, Aug. 18, 1964.
the cost of the premium, which may be substantial. At all events, the owner is able to make a rational choice. The State Bar Statute would deprive him of this choice. It would enrich the sureties by permitting them to receive large premiums for writing virtually risk-free bonds on all major jobs, while putting no pressure on them to write small, risky bonds. If some group is to be selected to receive what amounts to a royalty on major construction projects, another group might be considered more deserving—law students, perhaps.

In short, the State Bar Statute is a half-measure, at best. It would do some little good and perhaps cause some little harm. But it should not be enacted. If the legislature were to adopt it on the assumption that it would solve the problems of lienors and homeowners, any meaningful legislation on the problem would be precluded until the erroneous nature of that assumption were brought home to the legislature by another major scandal.

**PLANS REQUIRING ENFORCEMENT BY STATE AGENCIES**

If compulsory bonding is not the answer, what is? Here are some of the proposals which have come to the writer's attention.

A recent law review comment put forth a proposal for the elimination of the present mechanics' liens statutes, substituting a system of contractors' liens and mandatory bonding on all contracts exceeding 1,000 dollars, with a right in materialmen, subcontractors, and laborers to bring a derivative action on the contractor's lien on smaller jobs. This proposal is well thought out, and its authors make out a very good case for it. Unfortunately, it is open to the same objection as the other comprehensive compulsory bonding plan—it may alleviate a minor problem at great social cost.

Consideration has been given to the possibility of declaring money paid to the contractor to be a trust fund for the benefit of other persons entitled to liens which the contractor could divert to other uses only on pain of severe criminal sanctions. Aside from questions of the effectiveness of possible conviction of felony as a deterrent to misuse of funds, the chief objection to such a plan is that it would almost certainly be unconstitutional.

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75 For example, on a $2,500,000 contract, the premium would be approximately $15,000.

76 A repetition of the Los Angeles swimming pool scandal, for example, would not be prevented by enactment of the State Bar Statute. Nearly all swimming pool contracts are for less than $25,000, and would therefore not be covered by the statute.


78 Any comprehensive compulsory bonding plan could lead to the negative social consequences discussed above, since it would prevent unbondable contractors from operating, at least as general contractors.

79 FIFTH PROGRESS REPORT 79.

80 Misuse of funds is already grounds for disciplinary action, CAL. BUS. & PROF. CODE § 7108, yet the problem remains.
The answer has been thought to lie in tighter licensing requirements for contractors or requirement of license bonds. The bonds would inure to the benefit of the State, which would make disbursements among claimants, or to the benefit of those who might be injured by the contractor’s misconduct. Since a contractor’s financial condition may change radically after the issuance of a license, requirement of a higher degree of financial responsibility among license applicants would offer little assurance that the contractor would not get into difficulties by, for example, taking on a job which he was not equipped to handle. License bonds offer only limited protection and are very expensive. They also lead to enforcement headaches.

ELIMINATION OR LIMITATION OF LEINS

From the homeowner’s point of view, the most logical, direct, and conclusive solution would be the outright abolition of mechanics’ liens, or at least their limitation to the amount still owed by the owner to the contractor at the time the lien is filed. At first blush, this may seem a rather radical suggestion. Mechanics’ liens have been part of the California statutes for so long that the propriety of their retention is seldom questioned. But one might inquire whether current circumstances justify the retention of the mechanics’ lien laws. The origin of these liens is somewhat obscure. There is some evidence that they

81 CAL. PEN. CODE § 506, which makes it embezzlement for a contractor to divert funds, was held unconstitutional as applied to contractors in People v. Holder, 53 Cal. App. 45, 199 Pac. 832 (1921). The court held that any legislation which makes it a crime for one to use his own money for any purpose other than the payment of his debts violates CAL. CONSTR. art. I, § 15, prohibiting imprisonment for debt except in case of fraud. The court went on to say that if the statute purported to mean that the contractor, notwithstanding the provisions of his contract, holds the money in trust for others, it would be an unconstitutional deprivation of property without due process, and would violate CAL. CONSR. art. I, § 1 (freedom to contract with respect to property). The court also stated that “there can be nothing so injurious to the public welfare in the failure of a debtor to pay his just debts as to require an exercise of the police power.” 53 Cal. App. at 53, 199 Pac. at 836.

82 “[I]t is easier for a man to become a licensed contractor [in California] from the standpoint of financial responsibility than it is for him to buy a washing machine on time from Sears and Roebuck.” FIFTH PROGRESS REPORT 77 (remarks of Assemblyman Richard Hanna).

83 See note 34 supra.

84 The premium on a license bond is at least five per cent. Interview With Mr. Lee Cutler of Marsh and McLennan, Brokers, in San Francisco, Aug. 19, 1964.

85 At present, the Division of Labor Law Enforcement requires license bonds of all those engaged in the logging industry. The Division must correspond with each licensee to make sure his bond is renewed annually. The administrative problems are considerable, even for this relatively small group of licensees. Interview With Mr. William E. Fleck, Supervising Deputy Labor Commissioner, in San Francisco, Aug. 19, 1964.

86 The writer has found only two printed statements favoring their abolition.
were conceived with the chief purpose of aiding the laborer.\textsuperscript{87} Their very name tends to buttress this conclusion; "mechanic" is the older term for laborer or artisan.\textsuperscript{88} At the time of inception of these liens, men's consciences were beginning to stir at the plight of the laboring man. Mechanics' liens were conceived as a harmless method of securing the laborers' wages. There is strong evidence, however, that mechanics' liens are nearly obsolete as a wage-security device and are, by and large, no longer needed by the laborers.\textsuperscript{89} In this respect they may have outlived their usefulness.

The contractor, of course, has an unassailable moral right to assert a lien against the property he has built if he is not paid in full by the owner. Yet there is no need to give him a statutory lien, as he is in a position to exact lien rights from the owner by contract.

The subcontractor or materialman is in a somewhat different position. Usually not in privity of contract with the owner, he may obtain a lien only by operation of law. Therefore, if he is to retain any security interest in the goods he sells or in the products of his labor, he must be given a statutory lien. The question, then, is whether he should be entitled to such a security interest.

\textit{Basis of the Materialman's Claim to Lien Rights}

Let us consider first the materialman. When he sells to someone building a home or other structure for himself or for resale, the materialman functions as a retailer. He is able to obtain a lien by contract. This puts him on a parity with other retailers who can retain a security interest, usually in the form of a conditional sales contract, in the merchandise they sell on credit. However, when the materialman sells to someone acting as a contractor or subcontractor, he functions as a wholesaler. An ordinary wholesaler is unable to retain any security interest in the merchandise he sells to a retailer which cannot be cut off by resale to a "buyer in ordinary course of business."\textsuperscript{90} Therefore, wholesalers normally extend credit only to retailers who are good risks or who can put up security apart from the goods sold. Since the lien laws permit—indeed, encourage—materialmen to extend credit to a contractor regardless of his credit rating or the absence of nonstatu-

\begin{footnotes}
\footnotetext{87}{See 3 \textsc{Debates and Proceedings of the Constitutional Convention of the State of California of 1878-1879} at 1393-94, 1417-18 (1881).}
\footnotetext{88}{\textsc{Webster, New International Dictionary} (2d ed. 1934).}
\footnotetext{89}{See text accompanying notes 36-45 supra.}
\footnotetext{90}{"'Buyer in ordinary course of business' means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind . . . ." \textsc{Cal. Commercial Code} § 1201(9) (effective Jan. 1, 1965). Such a buyer takes free of any defect in the title of a merchant who has been "entrusted" with the goods, \textsc{Cal. Commercial Code} § 2403(2), and of a security interest created by his seller, \textsc{Cal. Commercial Code} § 9307.}
\end{footnotes}
tory security, they give materialmen a preferred position over other classes of wholesalers.

**Basis of the Subcontractor’s Claim to Lien Rights**

The subcontractor’s claims to lien rights stand on a somewhat surer footing. Like the laborer, the subcontractor expends his efforts in the construction of a building; unlike the laborer, he is given no statutory protection other than the lien laws. There is one notable group given statutory protection analogous to that afforded the subcontractor. This group includes repairmen and others who are given possessory liens on personal property which they repair or store. The analogy between the two groups is sufficiently well-drawn to state that mechanics’ liens are necessary to put subcontractors on a parity with those entitled to possessory liens—at least to the extent that the mechanics’ liens are limited to the amount owed by the owner to the contractor. In the case of mechanics’ liens not so limited, the analogy, as we shall see, breaks down.

**Limitation of Liens**

From the foregoing, it can be seen that the justification for mechanics’ liens is questionable at best (with the possible exception of subcontractors’ liens). There is, however, no good argument against the retention of limited liens (limited to the amount found due and owing from the owner to the contractor at the time the liens are filed). These limited liens can do little harm. They afford the lienors some protection against a defaulting homeowner and do not oblige them to rely on the contractor to secure their claims by enforcing his own lien. The owner cannot complain if he is forced to discharge fully the obligations of his contract or lose his property, so long as he is not required to pay more than the contract price. Indeed, no one can complain, except the owner’s general creditors.

Unlimited liens are quite another matter. In considering the propriety of unlimited liens, the basic question is whether the owner

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91 CAL. CIV. CODE §§ 3051-66.

92 There are two basic types of mechanics’ liens systems in the United States. Under the so-called “New York system,” the liens are derivative—i.e., the lienors are substituted to the rights of the contractor. Under this system, the liens are necessarily limited to the amount which the owner owes the contractor. Under the so-called “Pennsylvania system,” the liens are direct liens and, as in California, need not be limited. 36 AM. JUR. Mechanics’ Liens § 6 (1938); 57 C.J.S. Mechanics’ Liens §§ 105-06 (1955).

A variant of the “New York system” would give a lien to the contractor only and require others to use stop notices, which require the owner to withhold funds remaining in his possession. If such a plan were adopted in California, it would be advisable to revise CAL. CODE CIV. PROC. § 1190.1(b), which renders stop notices ineffective against a third party (e.g., a lender) holding the funds unless the person giving notice furnishes the holder of the funds a bond in the penal sum of 125% of the amount sought to be garnished.
should be made the involuntary guarantor of the fulfillment of another’s contract with a third party. When an owner in good faith pays the contractor in full, the contractor diverts the funds, and the unpaid claimants assert liens against the property, there are two sides with legitimate competing interests. The lienors claim the right to be compensated for the goods and services they have furnished the project, from which the owner has benefited. The owner claims the right not to have to pay more than once for the benefit he has received. In balancing these claims certain factors weigh against the lienors. The liens give the lienors a preferred position not given to other classes of laborers and businessmen. Even the analogy between the subcontractor and the repairman breaks down in the case of unlimited liens. The possessory lien on chattels does not usually impose “double payment” on the owner, as there is normally contractual privity between the owner and the repairman. Also, the presumption that every man knows the law is probably well founded in the case of the subcontractor and materialmen. Knowing his rights under the lien laws, he does not bother to get security from the contractor. In some cases he may cynically extend credit to a contractor whom he knows to be financially irresponsible, relying on his lien rights against the unsuspecting homeowner. The owner, on the other hand, though technically chargeable with knowledge of the law, cannot in fact be expected to be aware of the dangers confronting him and to guard against them.93

What can be said in favor of unlimited mechanics’ liens? It is undoubtedly true that they “grease the wheels” of the construction industry by permitting contractors to operate who could not otherwise get credit.94 In many cases this benefits the owner. But the price which the owner must pay when a job “goes sour” is so great that it is doubtful that any owner who truly understood the risks involved would take the chance.

Constitutional Basis

The record of the constitutional convention of 1878 as it relates to mechanics’ liens95 may shed some light on the intention of the delegates when they inserted the lien provision into the constitution. The delegates participating in the debate were obviously aware of the fact that an earlier decision96 had construed mechanics’ liens as limited to the amount found due and owing to the contractor. The drafting

93 See note 11 supra.
94 Hearing of the Senate Interim Judiciary Committee, at the Courthouse, Santa Barbara, California 156, Aug. 20-21, 1956 [hereinafter cited as Santa Barbara Hearing].
96 Renton v. Conley, 49 Cal. 185 (1874).
committee reported out the provision in the form in which it was ultimately enacted.\textsuperscript{97}

A Mr. Barbour introduced an amended version which would have made the liens unlimited and would also have made the owner personally liable for them.\textsuperscript{98} There was some talk of revising the offered amendment to eliminate the feature of personal liability while retaining unlimited lien liability. Such a revision was never made, so the delegates never had the opportunity to vote on the simple issue of limited versus unlimited liens. The proponents of the Barbour amendment indicated that their primary interest was in aiding the laborer; materialmen were included as potential lienors without any real reason for including them advanced.\textsuperscript{99} No one contended that it was proper that an innocent homeowner should be subjected to “double payment.” Instead, the proponents of the amendment assumed that the honest owner would be fully aware of the law and be able to protect himself.\textsuperscript{100} The principal argument in support of the Barbour amendment was that it would prevent “collusion” between “thieving contractors and scoundrelly owners who connive to swindle the workman out of his wages.”\textsuperscript{101} It seems that there had been at least one instance where an owner and contractor negotiated an undervalued contract. The actual construction cost exceeded the contract price by some sixty percent; the workmen and materialmen were able to collect from the contractor only the amount of the contract price and stood a loss as to the balance. This would be a sound argument in favor of unlimited liens if there were any evidence that such alleged “collusion” took place with any frequency. But it would seem that no contractor, honest or otherwise, would negotiate such a contract, as he would remain liable personally for the claims of the lienors, and this liability would wipe out any profit he might make by virtue of a secret deal with an unscrupulous owner. The opponents of the amendment used some rather strong language in asserting their position. One called the amendment a “fraud” and “infirm in principle.”\textsuperscript{102} At all events, the amendment was voted down. Since most of the speakers seemed to be of the opinion that unlimited liens would not be permitted under the constitution unless expressly authorized therein,\textsuperscript{103} the fact that

\textsuperscript{97} “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.” \textit{Cal. Const. art. XX, § 15.}

\textsuperscript{98} \textit{3 Debates and Proceedings of the Constitutional Convention of the State of California of 1878-1879 at 1393 (1881).}

\textsuperscript{99} Id. at 1394.

\textsuperscript{100} Id. at 1417.

\textsuperscript{101} Id. at 1394.

\textsuperscript{102} Id. at 1417.

\textsuperscript{103} Id. at 1393-94, 1417-18.
the Barbour amendment was defeated would seem to indicate an intention on the part of the delegates that unlimited liens should not be allowed. This cannot be stated with certainty, however, since one of the delegates was of the opinion that the provision as ultimately enacted would leave the question of limited or unlimited liens up to the legislature.¹⁰⁴ Thus, there remains the possibility that the delegates adopted his view, and decided to dump the question into the legislators' laps. It can be stated categorically that, since no one thought that innocent homeowners should be subjected to "double payment," the delegates did not give their stamp of approval in advance to the present scheme of mechanics' liens.

Conclusions on Elimination or Limitation

From the foregoing it will be seen that although subcontractors and materialmen can present legitimate claims to unlimited lien rights, it would seem that they are outweighed by the claims of the owners to protection from "double payment." As a matter of abstract justice, the laborers' liens are just as hard to justify. They give the construction worker a measure of protection not accorded to laborers in other fields. Yet this is all right if there is anything unique about the construction industry which would justify such a preference.¹⁰⁵ Assuming that there is, however, it does not necessarily follow that protection can best be afforded by unlimited mechanics' liens. Enforcement of these liens is time-consuming and difficult at best—ineffectual at worst. A better plan might be to require each contractor to obtain a rider to his workmen's compensation insurance policy which would insure his employees against loss of wages. This plan might have some objectionable features, and no investigation has been made into its feasibility. But if wage losses are the fault of the contractors, they should be compensated for by the contractors and not by the individual homeowners.

Despite all the arguments against unlimited mechanics' liens, limitation would not be indicated if there were any other acceptable means of doing justice to the homeowner. But there is not. None of the solutions considered in this comment, singly or in combination, would protect the homeowner in all cases. Consequently, limitation of liens to the amount which the owner owes the contractor seems to be the

¹⁰⁴ Id. at 1417.
¹⁰⁵ Such a unique feature has been suggested to be the fact that contractors have a significantly higher rate of business failures than other businessmen, and so subject their employees to an unusual risk of wage loss. The writer has not been able to find any evidence to support or refute this proposition. Assuming that it is true, it could well be the result of mechanics' liens, rather than a reason for their continuation. It has been asserted that the present mechanics' liens scheme has encouraged financially irresponsible persons to enter the contracting field by affording them easy credit. See Santa Barbara Hearing 25, 156.
only way to afford the homeowner complete protection. It is therefore recommended. However, there is no real hope that mechanics' liens can be limited. Any attempt to restrict these liens would be violently opposed by those who now benefit from the liens,\textsuperscript{106} and would be supported only by the few interested persons who have no axe to grind. The homeowners would be represented only in spirit, since they are largely ignorant of the present state of the law. It is perhaps too much to expect any legislature to enact a measure in the face of violent, organized opposition and little or no support, merely because it is the right thing to do. Therefore, it would be wise to consider a compromise solution.

Measures Aimed at Education or Notification of the Owner

Several types of "notice bills" have been proposed. They all assume that the homeowner lacks factual or legal knowledge and would be able to protect himself if properly enlightened. The so-called "Five-Day Notice Bill" would require potential lienors to notify contractor and owner of their contributions as a condition precedent to the validity of their liens. One variation of this has been adopted by the legislature.\textsuperscript{107} This bill would aid the honest contractor by informing him of unsuspected claims by those with whom he is not in privity. But it offers little aid to the homeowner, as the notices may carry no hint of their legal consequences, and even if they did, they would arrive too late for the homeowner to exact a bond that would give him statutory protection.\textsuperscript{108} Another "notice bill\textsuperscript{109}" would require the officer issuing a building permit to notify the owner that he may have to satisfy mechanics' liens out of his own pocket or lose his property, inform him how he may protect himself, and advise him to seek professional advice. Since the contract would be signed before the notice arrived, the bill, to be fully effective, would have to permit the owner to avoid the contract within a specified period if the contractor could not or would not obtain a bond. The merit of this plan depends upon what one considers to be the real problem. Is the real problem that the homeowner may be subjected to "double payment"? Or is it that it is unfair for him to be subjected to "double payment" because he is not aware of the law? If the unfairness of expecting the homeowner to be cognizant of an obscure law is recognized as the main evil, the bill is the answer. But it is questionable how many homeowners would pay attention to the notice and act upon it. Therefore, it may not be very effective in preventing actual losses. The question is one of social

\textsuperscript{106} See note 49 supra and accompanying text.
\textsuperscript{107} \textit{Cal. Code Civ. Proc.} \textsection{1193}. The notice must be given by personal service or registered or certified mail no later than fifteen days prior to the expiration of the period for filing liens.
\textsuperscript{108} \textit{Cal. Code Civ. Proc.} \textsection{1185.1}.
\textsuperscript{109} \textit{Fifth Progress Report} 116.
policy—how far should we go to protect a person from his own ignorance and carelessness? Additionally, the bill would protect the lienor only to the extent that the owner saw fit to protect himself. If the owner did not bother to require the bond, the lienor would be left where he is today.

Still another "notice bill" would require the contractor to notify the owner and lender of persons contributing to the work of improvement and to furnish the owner and lender with certified labor and material releases before being paid. The plan seems sound, but there is an enormous practical difficulty; particularly on large jobs, in ascertaining the identities of all laborers who worked on the project and obtaining releases from all of them. Anything less would not offer full protection.

Plans Requiring Enforcement by Private Individuals or Agencies

Another group of plans would condition the priority of the lender's trust deed on the contractor's furnishing adequate protection to lienors and owners, by bond or otherwise. One measure which has reached the legislature would make the lender's encumbrance prior to mechanics' liens only if the contractor obtained a Code of Civil Procedure section 1185.1 bond. Since a lender will rarely make a loan unless he is reasonably sure of the priority of his trust deed, this is really a compulsory bonding bill applicable only to construction financed by someone other than the owner. It is open to the same general objections as the other compulsory bonding bills.

A plan advanced by Mr. Glen Behymer of the Los Angeles Bar would make the lender's deed prior if a proper bond were furnished or if the owner, by terms in his contract, retained twenty-five per cent of the contract price until the period for filing mechanics' liens expired. This plan is much better and has a great deal of merit. But it would not afford protection where the contractor diverts funds from one or more of his earlier progress payments and then disappears or goes bankrupt, leaving unpaid claimants. Conceivably, on small jobs, the contractor might divert all or nearly all of his progress payments and abandon or complete the job leaving lien claims for up to seventy-five per cent of the value of the project. The amount retained in the hands of the owner would not satisfy these liens, the trust deed would have priority, and the liens would wipe out any interest the owner might have in the property, which would probably be insufficient to satisfy all of the lien claims. In the absence of evidence as to how often this

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110 Third Progress Report 77.
112 Id. at 82.
113 This is not an outright compulsory bonding bill. It would allow a solvent but unbondable contractor to function.
sort of thing happens, no satisfactory evaluation of the plan’s probable effectiveness can be made.

**THE ECLECTIC PLAN**

Although none of the above proposals by itself seems to offer a satisfactory solution, a selection of some of the best features of several leads to an apparently adequate solution which might not be too offensive to those now entitled to unlimited liens. This solution, the eclectic plan, is presented in the following paragraphs.

The plan would condition the priority of the lender’s trust deed on the contractor’s furnishing a section 1185.1 bond or other ironclad protection for lienors and owner.\[1\] The first step would be to provide that all persons who may wish to file liens (except laborers) must, as a condition of the validity of their liens, notify the contractor and owner (or money-lender, if there is one) that they have contracted to contribute to the work of improvement no later than ten days after having entered into such a contract. The notice would have to contain the names of the contracting parties and a general description of the labor or materials to be furnished. Section 1193 of the Code of Civil Procedure, which requires lienors (except laborers) to notify owner and contractor of their contributions within fifteen days prior to filing liens, could be amended so to provide.

Section 1188.1 of the Code of Civil Procedure, which deals with priorities, would then be amended to provide that mechanics’ liens would be prior to lenders’ trust deeds unless the contractor, owner, and lender entered into a specified binding agreement. The agreement would have to provide that the loan proceeds, together with the amount which the owner is contributing, should be placed with the lender and held as a trust fund\[1\] for the benefit of those entitled to

\[1\] **CAL. CODE CIV. PROC.** § 1189.1 uses such a plan with respect to site-improvement liens (liens provided for by **CAL. CODE CIV. PROC.** § 1184.1). Section 1189.1 permits the trust deed to be prior to mechanics’ liens only if a proper bond is furnished or if the loan proceeds are placed with the lender under an agreement that they will not be paid out, except in satisfaction of lien claims, until the expiration of the period for filing liens. This apparently works well in the case of site-improvements, which are relatively inexpensive and quick jobs. It would not be satisfactory if applied to general construction, however, as it makes no allowance for the customary (and necessary) practice of paying the construction funds out in installments.

\[1\] See S.B. 2194, 1957, in **SENATE INTERIM JUDICIARY COMMITTEE, 1955-1957, FOURTH PROGRESS REPORT TO THE LEGISLATURE 264-67.** This bill would condition priority of the trust deed on the filing of a bond or the placing of the loan proceeds in trust with the lender under an agreement that the fund could not be paid out or assigned until valid lien claims or notices to withhold were satisfied. The chief difficulty with this bill, apart from its virtual incomprehensibility, is that it (apparently) would permit the loan proceeds to be completely disbursed before the filing of liens or notices to withhold.
At least twenty-five per cent of the amount of the fund (i.e., the amount of the contract price) would have to be retained by the lender until the expiration of the period for filing mechanics' liens (other than contractors' liens). In addition, the lender would not be permitted to pay out any of the fund in the form of progress payments until he had received waivers of lien rights accrued as of the date the progress payment was due from those who had filed notices pursuant to section 1193. The contractor could obtain such waivers any way he chose. At least three methods suggest themselves: paying the claimants off in cash, convincing them of the contractor's good credit, or making assignments of the contractor's interest in the progress payments. The statute would have to determine the relative priorities of such assignments and assignments made for other purposes. The amount retained would normally be ample for the satisfaction of lien claims of laborers as well as those of persons who file claims for work done or materials furnished subsequent to the final progress payment. The plan would thus protect the homeowner from lien claims he could not satisfy. It would also protect subcontractors and materialmen unless they were foolish enough to waive their lien rights without adequate consideration. Laborers would be protected by the twenty-five per cent retention.

There are at least two disadvantages to the plan. The unbondbable contractor who lacked sufficient cash or credit to tide him over until he could receive the twenty-five per cent retention would probably be forced out of business, or at least out of general contracting. But since such contractors are likely to be the ones who present the greatest

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116 The lender would be performing a function presently performed on many jobs by the so-called "joint control industry." See Comment, 16 Hastings L.J. 229 (1964).

117 This is normally thirty days. See Cal. Code Civ. Proc. § 1193.1.

118 It is not certain that such claims would usually aggregate less than twenty-five per cent of the contract price. On the other hand, it has been asserted that even the twenty per cent retention under a former law (see note 119 infra) was adequate to satisfy such claims. Trans. Progress Report 82.

119 The plan bears some resemblance to the laws in force from 1885 to 1911. Under these laws contracts which were invalid left the property subject to unlimited mechanics' liens. A valid contract had to provide that the contract price was payable in installments at specified times, with at least twenty-five per cent payable not less than thirty-five days after completion. All contracts for more than $1,000 had to be in writing, filed, and recorded before commencement of work. It was said in Roystone Co. v. Darling, 171 Cal. 526, 154 Pac. 15 (1915), that these laws did not work well in practical operation. Disputes often arose over terms of contracts, time of maturity of installments, making of payments, time of beginning work with respect to filing of the contract for record, and other details. The eclectic plan would not seem to be open to the same objections. Disputes would normally not arise as to the validity of the contract since, even if the contract did not conform exactly to the statutory requirements, few claims of lien would arise if the lender in fact acted in good faith to protect lienors.
danger to lienors and owners, their departure could hardly be mourned.

The more serious disadvantage of the contract alternative is the work involved in meeting the terms of the requisite contract. The amount of paper work required to obtain waivers of lien rights would be great. Subcontractors, materialmen, contractors, and lenders would all be put to a great deal of bother. But this can be justified by the fact that each of them (except the contractor) holds a preferred position and can justly be called upon to make sacrifices for the protection of others in order to maintain his preferred position. For example, lienors are presently favored at the expense of the homeowner, and the lender is favored at the expense of lienors. The contractor does not hold a preferred position, except against the general creditors of a defaulting homeowner, but he is in a position to cause grave financial loss to others and so must be subject to some regulation. And the lienor or lender who wished to avoid all this bother would be free to do so—if he wanted to give up his preferred position. The lienor could simply fail to send the requisite notice, and the lender could take his chances with respect to priorities.

The advantages of the eclectic plan are numerous. The homeowner, of course, would be given substantial, if not complete protection. The lien claimant would have more security than he now enjoys. Even the lender would receive some benefit, as he would be able to remove any uncertainty as to his priority.\textsuperscript{120} No governmental agency other than the courts would be concerned with the enforcement of the plan.\textsuperscript{121} The lender would be made the policeman, required at his peril to insure that others were protected.

In practice the plan would probably result in compulsory bonding of all bondable contractors—compulsory bonding with a safety valve alternative that would insure against disastrous social and economic consequences. The contractor would have an incentive to get a bond, where presently he has none, both to avoid the bother of obtaining waivers and to escape the necessity for the twenty-five per cent retention. The lender, seeking to avoid any extra work, would no doubt insist on a bond wherever he could. But the lender is also anxious to make as many loans as possible. If he found enough bondable con-

\textsuperscript{120} At present the lender is not always able to be certain, before recording his trust deed, that work has actually not been commenced. If work has begun, a lender’s trust deed subsequently recorded will be junior to mechanics’ liens. Sax v. Clark, 180 Cal. 287, 180 Pac. 821 (1919); Wasco Creamery & Constr. Co. v. Coffee, 117 Cal. App. 298, 3 P.2d 588 (1931).

\textsuperscript{121} The courts would come into the picture only if an unpaid lienor contested the lender’s priority or sued the lender for breach of the third party beneficiary contract. Neither of these would occur if the lender acted in good faith to protect the lienors.
tractors to enable him to make maximum use of his funds, he would require a bond in every case. Otherwise he would make loans under the trust fund plan. The dangers attendant upon other compulsory bonding plans would thus be averted.\(^2\)

The plan is not complete. It would not protect anyone in cases where the construction was financed by the owner out of his cash reserves or out of the proceeds of a loan not secured by an encumbrance on the property. Where the work consisted of a small alteration job, however, the losses sustained would not be great. And in those relatively rare instances where the owner has the cash or credit to finance the construction of an entire home or other building, he is more likely to be aware of the desirability of consulting a lawyer in order to protect himself.

The suggested statute would cover speculative builders by defining them as contractors and their buyers as owners. It should not work a great hardship on large, honest tract developers, however. Should they consider bonding an unnecessary precaution, they would probably be in a position to demand waivers of lien rights on the part of all who contribute to the job before work begins. If the developer's credit is unquestioned, such demands would be readily honored; otherwise, he should be required to submit himself to measures which are necessary for the protection of others. If the proposal led to some successful, mild intimidation by contractors to obtain waivers, the "intimidatees" would only be giving up rights not enjoyed by other classes of businessmen, and they would still be doing so voluntarily.

Suggested statutory amendments are set out in the Appendix. Any proposal to enact these or similar statutes would face rough going. Strong objections could be expected from those who would be adversely affected—particularly the lenders, who do not want to have their priorities conditioned on anything. But it is submitted that in considering such statutes, the legislators should give primary consideration to the needs of the "forgotten man" of mechanics' lien laws—the homeowner—and act accordingly.

**APPENDIX—SUGGESTED STATUTORY AMENDMENTS**

<table>
<thead>
<tr>
<th>Present Code</th>
<th>Amended Code</th>
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<tbody>
<tr>
<td>California Code of Civil Procedure, § 1193(a). Written notice; persons required to give; contents. Except one under direct contract with the owner or one performing actual labor for wages,</td>
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</tbody>
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\(^2\) One objection to compulsory bonding, however, would not be overcome. It would still be difficult for young men to enter the field of general contracting.
present code

every person who furnishes labor, service, equipment or material for which a lien otherwise can be claimed under this chapter, must, as a necessary prerequisite to the validity of any claim of lien subsequently filed, cause to be given not later than 15 days prior to the filing of a claim of lien a written notice as prescribed by this section, to the owner or reputed owner and to the original contractor. The notice shall contain a general description of the labor, service, equipment or materials furnished, the name and address of such person furnishing such labor, services, equipment or materials, and the name of the person who contracted for purchase of such labor, services, equipment or materials. If an invoice for such materials contains this information, a copy of such invoice, transmitted in the manner prescribed by this section, shall be sufficient notice. The notice may be sent at any time after any labor, services, equipment or materials are furnished, but in no event later than fifteen (15) days prior to the expiration of the time within which to file a claim of lien.

amended code

every person who furnishes labor, service, equipment or material for which a lien otherwise can be claimed under this chapter must, as a necessary prerequisite to the validity of any claim of lien subsequently filed, cause to be given not later than 10 days after such person has entered into a contractual agreement to contribute to a work of improvement, a written notice as prescribed by this section, to the owner or reputed owner and to the original contractor. If the owner has designated any lender, as defined in section 1188.1 of the code of civil procedure, or any surety as his agent to receive the notices provided for by this section, such notices must be given to such agent, rather than to the owner. Such designation may be made known upon the face of the building permit, or by notice attached to the building permit, but any person required to file notices under this section shall be charged with knowledge of such designation if he in fact receives such knowledge by any means. The notice shall contain a general description of the labor, service, equipment or materials to be furnished, the name and address of such person furnishing such labor, services, equipment or materials, and the name of the person who contracted for purchase of such labor, services, equipment or materials. If an invoice for such materials contains this information, a copy of such invoice, transmitted in the manner prescribed by this section, shall be sufficient notice.

128 this change in the statute would no doubt cause some hardship to lien claimants. Though they are at present required to give a similar notice, they need not do so until fifteen days prior to the expiration of the period for filing liens. Thus, they presumably wait until the last minute and give notice only if they have not yet been paid. Under this amendment they would be obliged to give notice promptly after entering into a contract to contribute to the improvement unless they were satisfied with the contractor's unsecured credit.

124 this is designed to encourage contractors to pass word down to the other claimants as to whom to notify. If in doubt, the claimants could verify the contractor's word by a telephone call to the lender, without the necessity of checking the building permit.

california code of civil procedure, § 1188.1. preferences. for the purposes of this section, the term contractor shall include any person who

california code of civil procedure, § 1188.1. preferences. (a) definitions.

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Amended Code
contracts directly with an owner for improvement of real property in which the owner has an interest, and any person who contracts, through an agent or otherwise, with an owner to improve real property and to convey a freehold interest in the same to the owner upon completion of such improvement. 125

The term "owner" shall include any person who has an interest in real property and who contracts with a contractor for the improvement of real property, and any person who contracts to purchase any freehold interest in any unfinished structure, and/or the land thereunder, upon the completion of said structure. Any monetary consideration in excess of $100 given by an owner for such contract of sale shall be deemed to be a "sum to be contributed by the owner to the work of improvement" within the meaning of subdivision (b) of this section. 126

The term "lender" shall include any person, corporation, association, partnership, or other organization which shall make any loan for the purpose of financing any work of improvement upon real property, as consideration for which the lender receives a mortgage, deed of trust, or other encumbrance upon such real property or work of improvement as security for the loan.

(b) The liens provided for in this chapter, except as otherwise in this article provided, are preferred to any lien, mortgage, deed of trust, or other encumbrance upon the premises and improvements to which the liens provided for in this chapter attach which may have attached subsequent to the time when the building, improvement, structure, or work of improvement in connection with which the lien claimant has done his work or furnished his material was commenced; also 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 building, improvement, structure, or work of improvement on which such lien claimant has done his work or for which he has furnished his material, appliances or power was commenced.

A mortgage or deed of trust which would be prior to any of the liens provided for in this chapter to the extent of obligatory advances made thereunder in accordance with the commitment of the lender shall also be prior to the liens provided for in this chapter as to any other advances, secured by such mortgage or deed of trust, which are used in payment of any claim of lien as provided for in this chapter, if any, which is recorded at the date or dates of such other advances and thereafter in the payment of all or any part of the costs of any work of improvement on the property which is subject to such mortgage or deed of trust; provided, that the priority of such mortgage or deed of trust shall not exceed in total for both obligatory advances made in accordance with the commitment of the lender and other advances the amount of the original obligatory commitment of the lender as shown in said mortgage or deed of trust.

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125 This is designed to cover the speculative builder who contracts with a buyer to sell him a lot and building when the building is completed and gets a down payment before completion. The buyer often loses his down payment if the builder fails.

126 The effect of this provision, read in connection with the remainder of the statute, would be to require the buyer's down payment to be placed in "escrow" with the lender. It could not be paid out until all lien claims were satisfied. "Binders" not exceeding $100 would be exempt.
Present Code

ant had no notice and which was un-
recorded at the time the building,
improvement, structure, or work of im-
provement on which such lien claimant
has done his work or for which he has
furnished his material, appliances or power
was commenced; provided, however that
any mortgage, deed of trust, or other en-
cumbrance held by a lender shall, in all
cases, be preferred to the liens provided
for in this chapter if, and only if, one of
the following is true:

A statutory labor and material bond is
filed. Such bond must conform to the
requirements of Section 1185.1 of the
Code of Civil Procedure as to the pro-
visions of the bond, and must be properly
filed and recorded, along with the con-
tact, as provided by that section; or

A binding contract, containing the
terms hereinafter provided, is executed by
the owner, contractor, and lender. Such
contract must provide that:

The loan proceeds, together with the
sum to be contributed by the owner to
the work of improvement, shall be placed
with the lender as a trust fund for the
benefit of persons entitled to liens by this
chapter.

Not less than twenty-five per cent of
the amount of the trust fund shall be re-
tained by the lender until such time as
the period for filing of liens provided by
this chapter, other than liens of original
contractors, has expired. The sum to be
contributed by the owner shall be deemed
to be included in the amount required to
be retained by the lender, to the extent
that it does not exceed such amount.\(^\text{127}\)

The lender shall not pay out any
amount of the trust fund, as advances or
progress payments or otherwise, until and
unless the contractor shall have furnished
to the lender written waivers of lien rights
from all persons who have given or caused
to be given notices to the owner or lender,

Amended Code

\(^{127}\) At present many contractors are able to convince unwary owners to pay them, in
advance of beginning work, the amount, or some part of it, that the owner himself is
putting up. This provision would stop that by assuring that any money paid the
contractor before the expiration of the lien-filing period comes out of the lender's
pocket. The lender will presumably make no payments until work has progressed
sufficiently so that the payments are not greater than the lender's security interest in
the building.
pursuant to Section 1193 of the Code of Civil Procedure. Such waivers must waive all lien rights which have accrued as of the date on which, by agreement between the contractor and the lender, such advance or progress payment is due. Provided, however, that if any person shall refuse to waive his lien rights, the lender may, with the consent of the contractor, withhold the amount claimed by such person, pending adjudication or agreement of the parties as to its disposition, and pay the balance of such advance or progress payment to the owner or contractor. The owner must designate the lender as his agent for the service of notices required to be given by Section 1193 of the Code of Civil Procedure, as provided in that section.

Such contract must inure to the benefit of persons entitled to the liens provided for by this chapter, to give such persons a right of action against any party to the contract, for damages proximately resulting from the failure of that party to adhere to the terms of the contract.

Any assignments of the contractor’s interest in any part of the trust fund made to persons entitled to file liens, in order to obtain waivers of lien rights, shall be prior to any assignments made to other persons.128

The provisions of this section shall not apply to liens provided for by Section 1184.1 of the Code of Civil Procedure, the priority of such liens being as provided by Section 1189.1(b) of the Code of Civil Procedure.

128 Statutory regulation of the priority of these assignments is necessary to facilitate assignments to lienors by assuring the assignee that his assignment will not be subordinate to one made by the contractor to one of his general creditors.