

REPRESENTING THE SMALL TO MEDIUM SIZED
MECHANIC'S LIEN CLAIMANT

INTRODUCTION

When a contractor, subcontractor, material supplier, or equipment lessor is not paid on a construction project, there are three generally recognized remedies available to assist in the enforcement and collection of the debt: (1) the mechanic's lien, (2) the stop notice, and (3) the payment bond. These remedies are statutory and are cumulative: an action for breach of contract, to foreclose a mechanic's lien, to enforce a stop notice, and to recover on a payment bond may be pursued simultaneously. This outline is limited to mechanic's lien claims and the steps a lien claimant may take to maximize any recovery. It is not intended to take a lien claimant through trial. Its focus is on issues which may assist counsel and the lien claimant to achieve an early favorable resolution of the claim. It will identify the issues common to mechanic's lien claims without focusing on the technical requirements for a specific jurisdiction.

OVERVIEW

A Mechanic's Lien is a creature of statute, and it has no existence at common law or in equity. It is a claim created by statute for the purpose of protecting the rights of those who improve the property of another. By enactment of the statutes, the legislatures of the various states have afforded certain protections to those who labor to improve the property of others. The balance between the rights of the lien claimant and the rights of the owner differ, depending upon the legislative enactments.¹

In some states, the primary purpose of Mechanic's Lien statutes is to protect the rights of contractors and materials suppliers who enhance the value of the property of another.² The legislature has balanced the rights of the lien claimant against the rights of the owner in favor of the lien claimant. The Mechanic's Lien statutes have been viewed as remedial statutes, and courts have liberally construed them to protect those who furnish labor and material to improve the property of another. In some instances, legislatures and courts have allowed substantial compliance with certain the statutory requirements to enable lien claimants to enforce their lien rights.³

¹ Marsh, California Mechanic's Lien Law, 6th Ed. §§ 1.1, 1.3.

² E.g., Cal. Const., Art. 14, § 3 and Civil Code §§ 3109, et seq; Ariz. Rev. Stat. Art. 6, Chap. 7, Title 33; Nev. Rev. Stat. §§ 108.222, et seq.

³ MLM Constr. v. Pace Corp. 172 Ariz. 226, 836 P.2d 439 (Ct. App. 1992); Tigard Sand & Gravel v. LBH Constr. 149 Or. App. 131, 941 P.2d 1075 (1997); Calif. Civil Code § 3261.

Other states take a more restrictive view, demanding strict compliance with the statutory requirements regarding the creation, perfection and enforcement of a Mechanic's Lien. The statutes are narrowly construed against the lien claimant.⁴

The right to a Mechanic's Lien is clear. The procedures to create, perfect, and enforce a Mechanic's Lien, however, have never been simple, and they are filled with pitfalls and traps for the unwary/inexperienced practitioner. The statutes are subject to frequent amendment, revision, and judicial interpretation. The statutory Mechanic's Lien and parallel stop-notice procedure are complex. Analysis of whether a Mechanic's Lien or stop-notice claim is perfected or is time-barred or is otherwise defective can be difficult. The resolution of the disputed issues oftentimes depends upon several factors, not the least of which is when did work on the project start and when did it end.⁵

Despite the complexities and differences among the various state statutes, there are some general steps one may take to facilitate the resolution of a disputed lien claim.

ADVISING THE CLIENT

Before Construction

If the client consults with counsel before the construction project, the following issues should be addressed. Counsel should review the contract to eliminate any ambiguities.

Counsel should confirm how contract "extras" will be treated. The procedures for change orders, requests for information and field work authorizations must clearly be set forth. Counsel should ascertain whether a payment bond has been provided for the project. Obtain a copy of the bond including where to send notice of a claim. Contractors, subcontractors and material men are obligees under the bond. Counsel should identify the owner and the construction lender, including addresses. Counsel should also confirm the disbursement procedure, i.e., when progress payments are made to the general contractor, will the subcontractor be named as an additional payee on the disbursement check. On smaller to medium sized projects, always insist that the client subcontractor be included as a named payee on any disbursement checks for work being performed by the client.

Counsel should review with the client the preliminary notice requirements and timing requirements so that the client may fully comply with the statute. Additionally, counsel should advise the client to keep accurate records, including job cost data and a daily job log.

⁴ Consolidated System, Inc. v. Amisub, Inc. 261 Georgia 590, 408 Se.2d 109 (1991); Palmer v. Duncan Wholesale 262 Georgia 28, 413 Se.2d 437 (1992); Hartford Accident and Indemnity Co. v. American Country Clubs 353 So.2d 1147 (Ala. 1977); Covington County Bank v. R. J. Allen & Associates 462 F.Supp. 413 (M.D. Ala. 1977); Fisher Bros. v. Harrah Realty Co. 92 Nev. 65, 545 P.2d 203 (1976).

⁵ Lambert Steel v. Heller, 16 Cal.App.4th 1034 (1993) (temporary fencing); South Bay Engineering v. Citizens Savings & Loan, 51 Cal.App.3d 453 (1975) (survey stakes and markers).

After Commencement of Construction

If the client consults with counsel after the construction has commenced, when the project has either been completed or work has ceased, counsel must expeditiously deal with several issues. Counsel must ascertain how much time, if any, remains to create, perfect and enforce the mechanic's lien, i.e., timely service of the preliminary notice, timely recordation of the mechanic's lien, and timely filing of the lawsuit to foreclose the lien. Oftentimes the client has already recorded the claim of lien and there is very little time within which to file the lawsuit. Counsel should obtain the relevant documents from the client regarding the project and analyze the merits of the claim, including priority, and any claims based upon contract "extras".

Once counsel is satisfied that the statutory and technical requirements to perfect lien rights have been met, counsel should discuss pre-litigation resolution of the claim. Issues to be discussed include (1) priority of lien; (2) costs of litigation; (3) use of arbitration; (4) defense strategy designed to make lien claimants spend money litigating the case. A cost-benefit analysis will provide the client with information necessary to make a reasoned decision.

Counsel must address the priority issue, i.e., does the lien have priority over the construction loan. If priority is not an issue, i.e., the lien claimant does not have it, then litigation to foreclose a Mechanic's Lien in a position junior to a large construction loan presumably in default is not particularly appealing. It reduces the settlement value of the lien claim. If, on the other hand, priority is a disputed issue, it will add leverage for purposes of settlement and litigation. Counsel must also discuss the cost of the litigation, and whether attorneys' fees may be allowed to the prevailing party as a part of any recovery. If attorneys' fees are not recoverable as part of the lien claim, they may nonetheless be recoverable under the contract. However, collectability is an issue. If attorney's fees are allowed to the prevailing party, any award is typically within the discretion of the trial court. Moreover, the maximum recovery may be limited by statute. Counsel should also inform the lien claimant that the defense strategy will be simple but costly: (1) divide and conquer/war of attrition; (2) make the lien claimant prove statutory and technical compliance; (3) make the lien claimant prove reasonable value and/or contract amount; (4) dispute the contract extras; and (5) settle on terms favorable to the defense.

Once the client has been fully informed of the different aspects of the litigation, discuss the amount which the client is willing to compromise the claim. Counsel should then attempt to resolve the dispute before litigation.

Once the client has instructed counsel to commence litigation, counsel must purchase a preliminary report or litigation guarantee. Inform the client that it is not negotiable and is an essential part of the litigation. If the client refuses to pay the cost, counsel should consider buying one anyway. Failure to obtain either an preliminary report or litigation guarantee may be considered malpractice.

Most contracts include arbitration clauses. Counsel should review the arbitration clause and any assumption of contract clauses.⁶ The subcontractor may assume certain provisions of the general contractors contract with the owner. In that scenario, an arbitration

⁶ Slaught v. Bencomo Roofing, 25 Cal.App.4th 744 (1994).

clause in the contract may be enforced by a subcontractor against the owner. It may not be enforceable against the construction lender who is not a party to the construction contract. If the arbitration clause is applicable, then use it to compel arbitration.

In addition to the mechanic's lien foreclosure cause of action, the complaint will typically include a cause of action for breach of contract and a common count (quantum meruit). If appropriate, counsel should include a stop notice cause of action and a claim on the bond. It should be noted that even in the absence of a payment bond, many general contractors have a license bond in place that is predicated on the contractor's "faithful performance" of its duties. The complaint will, of course, include an allegation that the general contractor breached the contract with the subcontractor and has not faithfully carried out its duties. In the appropriate case, counsel should also consider adding a cause of action for equitable relief based upon unjust enrichment. In some jurisdictions, claims for equitable relief in a mechanic's lien situation, are not allowed.⁷ In other jurisdictions, an unjust enrichment claim may be considered by the court.⁸ Counsel should also consider including a cause of action against the lender based upon negligent or improper disbursement of loan proceeds. This will expand the scope of the litigation but may expose additional liability on the part of the lender, and may result in more money being made available for settlement purposes.

Counsel should investigate the status of the other unpaid lien claimants. Where there are several unpaid lien claimants, counsel should consider the possibility of forming a committee to act on behalf of a group of lien claimants. This is a very effective strategy to counter the defense divide and conquer approach. If there are other unpaid lien claimants who have filed actions, counsel should also consider filing a motion to consolidate the various lawsuits. Consolidation allows later filed lawsuits to be placed on equal footing with earlier lawsuits so that the lien claimants share proportionately in the equity in the property. When the various lawsuits have been consolidated, it is more difficult for the defendants to make disproportionate settlements. Additionally, counsel can observe the litigation between other parties as to the contested issues. If the litigation of the contested issues is progressing favorably, then counsel can simply sit on the sidelines. If the litigation of the contested issues is not proceeding favorably, counsel can become more involved in the active litigation of the case.

In conclusion, counsel must remain focused on the objective – maximize recovery and minimize expense. This can best be accomplished prior to or early on in the litigation. If litigation ensues, counsel must quickly analyze the merits of the case to determine the strengths and weaknesses in the case. Counsel must then establish the settlement value of the case with the client. With that in mind, Counsel will then be able to use his or her negotiation and litigation skills to posture the case for a favorable settlement or litigation result.

⁷ Nibbi Bros. v. Home Federal S&L 205 Cal.App.3d 1415 (1988); Boyd & Lovesee Lumber v. Western Pacific Financial 44 Cal.App.3d 460 (1975).

⁸ Columbia Wholesale Co. v. Scudder May, 440 S.E.2d 129 (S.C. 1994).

I. BEFORE CONSTRUCTION —PRELIMINARY CONSIDERATIONS

- A. Contract–AIA Form Contract (Exhibit 1)
 - 1. Specifically identify what work/material are included within contract
 - 2. Specifically identify what is not included
- B. Identify owner and construction lender
- C. Payment and Performance Bond
 - 1. Subcontractor and materialman as obligee on the bond
 - 2. Bond claim procedures clearly identified
- D. Contract Changes/Extras
 - 1. Change Order Procedure Identified in Contract
 - 2. Request for Information Procedure Identified in Contract
 - 3. Field Work Authorization Procedure Identified in Contract
- E. Project Documentation
 - 1. Job Cost Data
 - 2. Personnel Records
 - 3. Daily Job Log
- F. Time Check Lists: Compliance with statutory preliminary notice requirements at start of project or when contractor first supplies materials or labor to project. (Exhibit 2)
- G. Contractor’s License: may be required in order to enforce mechanic’s lien rights. Cal. Business & Professions Code § 7031; Construction Financial v. Perlite Plastering 53 Cal.App. 4th 170 (1997)
- H. Corporate Status: suspended corporation may not be allowed to enforce its rights while suspended. Cal. Business & Professions Code §§ 7000-7173

II. AFTER CONSTRUCTION—PRELIMINARY INVESTIGATION/STATUTORY COMPLIANCE

- A. Lien Claimant Defined: general contractor, subcontractor, materialman, or equipment lessor, defined by specific state statute. Cal. Civil Code

§§ 3110, 3112; Ga. Code Ann. §44-14-361; Primo Team v. Blake 3 Cal.App. 4th 801 (1992) (office administrator is not proper claimant)

B. Preliminary Notice

1. Mandatory in some states: Cal. Civil Code §3097; Ariz. Rev. Stat. Ann. § 33-992.01; Or. Rev. Stat. § 87.021(1).
2. Optional or not required in some states: Ga. Code Ann. § 44-14-361.3; Ala. Code § 35-11-210.
3. Distinction between original contractor (contract with owner) and subcontractor/materialman and second and third tier subcontractors or suppliers (no contract with owner). Cal. Civil Code § 3097; Nev. Rev. Stat. § 108.245; N.C. Gen. Stat. §§ 44A-8, 44A-19.
4. Notice given to owner, construction lender, general contractor, subcontractor. Cal. Civil Code § 3097; Ga. Code Ann. § 44-14-361.3
5. Timely served: there are strict time limitations; some jurisdictions allow late notice. Cal. Civil Code § 3097(d); Ariz. Rev. Stat. Ann. § 33-992.01; Or. Rev. Stat. § 87.021(1).
6. Content of Preliminary Notice: include necessary information, i.e., identify owner, construction lender, property location, type of work to be performed, contract amount, and party to contract. Cal. Civil Code § 3097(c); Ga. Code Ann. § 44-14-361.3.
7. Exception: May arise from estoppel or actual knowledge on the part of the owner. Kim v. JF Enterprises 42 Cal.App. 4th 849 (1996) (estoppel); Truestone v. Simi West 163 Cal.App. 3d 715 (1984) (actual knowledge of owner; no prejudice)

C. Mechanic's Lien

1. Timely recorded and served: the time typically runs from completion of the project (or cessation of work when materials or labor were last supplied to the project). Calif. Civil Code §§ 3115, 3116 and 3117. In some jurisdictions, the lien claimant is allowed to re-record a lien where the statutory requirements are otherwise met. Solit v. Tokai Bank, 68 Cal.App. 4th 1435 (1999); Koudmani v. Ogle 47 Cal.App. 4th 1650 (1996); Gaston Grading & Landscaping v. Young, 116 N.C. App. 719, 449 S.E. 2d 475 (1994) (lien cannot be amended but may be canceled and a new lien substituted in its place provided it is timely).
2. Content of Mechanic's Lien: include necessary information, i.e., amount of claimant's lien after deducting credits and offsets, identify owner,

identify work performed, and identify the property subject to the lien. Cal. Civil Code § 3084.

3. Completion of the Project: defined per statute or judicial decision. Cal. Civil Code §§ 3093/3086
4. Cessation of Work: defined per statute or judicial decision. Cal. Civil Code §§ 3086, 3092
5. Cessation– effect: starts statute of limitations within which to perfect and enforce lien rights. Cal. Civil Code §§ 3115, 3116, 3086

D. Priority

1. Recordation Date of Mechanic’s Lien (Cal. Civ. Code § 3134)
2. Site Improvements Cal. Civil Code §§ 3135, 3137; Lambert Steel v. Heller 16 Cal.App. 4th 1034 (1993) (site prep)
3. Relation back to commencement of project. Lambert Steel v. Heller, 16 Cal.App. 4th 1034 (1993)(temporary fencing); South Bay Engineering v. Citizens Savings & Loan 51 Cal.App. 3d 453 (1975) (survey stakes and markers)

E. Fraud–Forfeiture of Lien: Cal. Civ. Code § 3118; Burton v. Sosinsky 203 Cal.App. 3d 562 (1998)

III. AMOUNT OF THE LIEN CLAIM

A. Reasonable Value/Contract Amount, whichever is less. Cal. Civil Code §§ 3123, 3124, 3140; Ariz. Rev. Stat. Ann. § 33-981(B); Ga. Code Ann. § 44-14-361.1(e).

B. Factors affecting Reasonable Value.

1. Substandard Labor
2. Substandard Materials
3. Failure to follow plans and specifications
4. Backcharges
5. Damage to Work of Others

C. Other Amounts Recoverable or in Dispute

1. Attorneys’ Fees:

- (a) not allowed: Royster Const. Co. v. Urban West Communities (1995) 40 Cal.App. 4th 1158; Abbett Electric v. California Federal S&L (1991) 230 Cal.App. 3d 355; Ala. Code § 35-11-210, Sherman v. Greater Mount Olive Baptist Church (Ala.Civ.App. 1996) 678 So. 2d 156
 - (b) allowed per statute/court discretion. Ore.Rev.Stat. § 87.060(5); So. Carolina Code Ann. §§ 29-5-10, 29-5-20; No. Carolina Gen. Stat. § 44A-35; Gaster Lumber Co. v. Browning (1995) 219 Ga.App. 435, 465 S.E.2d 524, aff'd 267 Ga. 72, 475 S.E.2d 576 (1996).
2. Interest allowed: Royster Const. Co. v. Urban West Communities (1995) 40 CA 4th 1158; Clark v. Safeco (1997) 15 Cal. 4th 882; P&C Construction Co. v. American Diversified, 101 Or. App. 51, 789 P.2d 688 (1990).
 3. Costs are generally recoverable by prevailing party. (C.C. § 3150)
 4. Scheduling or Delay Damages: Lambert v. Superior Court (1991) 228 Cal.App. 3d 383 (not allowed as part of lien)
- D. Conditional Waiver/Unconditional Waiver upon receipt of progress payments. Use of most recent form is essential. MLM Construction v. Pace, 172 Ariz. 226, 836 P.2d 439 (Ct.App. 1992); J.A. Jones Construction v. Superior Court, 27 Cal.App. 4th 1568 (1994) (use of old form requires following prior law); Western Landscape v. B of A, 58 Cal.App. 4th 57 (1997) (waiver may not apply to retention).
- E. Pay if Paid–Waiver of Lien. Clark v. Safeco (1997) 15 Cal. 4th 882 (invalid provision because it constitutes a waiver of lien rights); Ga. Code Ann. § 44-14-361.1(4) (gives protection to subcontractors by preserving lien rights).

IV. LITIGATION

- A. Obtain preliminary report or litigation guarantee: Name all parties to be bound or suffer the consequences. Birmingham Lumber v. Lovejoy (Ala. 1997) 705 So. 2d 440. Pickett v. Commanche Constr., 108 Nev. 422, 836 P.2d 42 (1992); Packard Bell v. Theseus (1966) 244 Cal.App.2d 355.
- B. Always Allege Priority against owner and lender. (Calif. Civil Code § 3136)
- C. Timely Filed in Correct Court–in county where property located and in court of proper jurisdiction; Cal. Civil Code § 3144; Automatic Sprinkler Corp v. Southern Cal. Edison (1989) 216 Cal.App. 3d 627 (wrong county); Halberts Lumber v. Burdette (1988) 202 Cal.App.3d Supp. 14 (wrong judicial district)

- D. Record Notice of Lis Pendens immediately. Or. Rev. Stat. § 93.740; Ariz. Rev. Stat. Ann. § 12-1191, 33-998; Packard Bell v. Theseus (1966) 244 Cal.App.2d 355.
- E. Arbitration clauses: enforcement Slaught v. Bencomo Roofing (1994) 25 Cal.App.4th 744 (enforceable provision)
- F. Strategy issues
 - 1. Lien Claimant: Strength in numbers
 - 2. Defense: Divide and conquer/war of attrition
 - 3. Discovery
 - (a) Document Request: job cost data; project administration; consider voluntarily producing documents.
 - (b) Interrogatories: information regarding license; corporate status; date of start, stop; type of work; who present at site; job cost.
 - (c) Depositions: limited value vs. cost and expense
 - (d) Informal interviews with on-site personnel

ADDENDUM—Recent Cases of Interest

1. Clarke v. Safeco, 15 Cal.4th 882 (1997).

"Pay-if-paid" contractual provision constitutes an improper waiver of mechanic's lien rights and is void as against public policy. This is a 4-3 decision of the California Supreme Court where the majority held that if a general contractor is not paid and therefore owes no money to the subcontractor, the mechanic's lien statute, Civil Code § 3262, which allows for recovery of the reasonable value of goods and services or the contract amount, whichever is less, resulted in a zero mechanic's lien because technically no money is due under the contract. The dissent noted that the contract provisions in question included an express reservation of mechanic's lien rights, and the subcontractor could thus enforce the same. The pay-if-paid provision does not impact upon the subcontractor's mechanic's lien rights and is now not a defense in a contract action.

2. Solit v. Tokai Bank, 68 Cal.App.4th 1435 (1999) and Koudmani v. Ogle, 47 Cal. App. 4th 1650 (1966).

Recordation of a second mechanic's lien (pertaining to same materials and work covered under the first mechanic's lien) is allowed if the statutory requirements are otherwise met, i.e., the time to record a mechanic's lien has not expired. The cases discuss the constitutional right to a mechanic's lien versus enforcement of the lien.

3. Construction Financial v. Perlite Plastering, 53 Cal. App. 4th 170 (1997).

Contractors license is required to bring an action to recover for work performed or goods and materials provided to the job site. Earlier cases regarding substantial compliance with the licensing requirement have been superseded by statute. Business and Professions Code § 7031 establishes three requirements to enable a contractor to recover: (1) licensed within 90 days of the work performed; (2) license was for the type of work performed; and (3) non-compliance with the licensing requirement was a clerical error and not due to the negligence of the contractor.

4. Golden Eagle Ins. Co. v. First Nationwide, 26 Cal. App. 4th 160 (1994).

Surety can be subrogated to mechanic's lien claim based upon the doctrine of equitable subrogation. A written assignment was surplusage and irrelevant because the principles of equitable subrogation apply to determine whether or not subrogation will be allowed, regardless of any written assignment. Therefore, the doctrine of superior equities applies. One factor to be considered is whether the owner has already paid for the work which forms the basis of the mechanic's lien claim.

5. Angelus Electric v. Superior Court, 27 Cal. App. 4th 426 (1994).

Payment by a general contractor to a subcontractor within 90 days of an assignment for the benefit of creditors is a recoverable preference under Code of Civil Procedure § 1800. In 1979, the California legislature enacted a statutory scheme for the recovery of preferences by an assignee for the benefit of creditors. The California statute is almost identical to the analogous provision of federal bankruptcy law, 11 U.S.C. § 547. In this case, the general paid the sub who then released its mechanic's lien. Within 90 days, the general made an assignment for the benefit of creditors. The court held that the release of a mechanic's lien as to a third party is not new value to the contractor.

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