Study H-820 June 15, 2000

First Supplement to Memorandum 2000-36

Mechanic's Liens: Constitutional Issues (Abdulaziz Letter)

Attached to this supplement is a letter from Sam K. Abdulaziz responding to the analysis of constitutional issues in Memorandum 2000-36. (The letter has been converted from an emailed file, so it will look different from the original; in the interest of early distribution, we are sending the converted file.)

One or two points need clarification: Mr. Abdulaziz faults the staff for glossing over recent cases protecting the sanctity of the mechanic's lien, specifically *Connolly* and *Wm. R. Clarke v. Safeco*. (See Exhibit pp. 1-3.) In general, *Connolly* is not relevant to the question whether a good faith payment defense would be constitutional, because the constitutionality of the mechanic's lien itself was the issue in that case. (The case is noted on page 19 of Memorandum 2000-36.) Questions of state action, fundamental to determining whether a taking is unconstitutional, are not germane to our issue. The balancing exercise in *Connolly* took place to determine whether the taking without notice could withstand constitutional scrutiny. (Even then, three justices disagreed.) *Connolly* is of interest to our question because it illustrates that balancing can and does take place; it is not relevant to the issue of whether the Legislature can constitutionally balance the interests of owners of single-family, owner-occupied dwellings and mechanic's lien claimants through a rule protecting the owner from double payment liability.

In *Wm. R. Clarke v. Safeco*, a divided court struck down pay-if-paid clauses in contracts between contractors and subcontractors. Perhaps we could have devoted more discussion to this case, but since it involved *contractual* waivers of an important constitutional right *against* public policy, we didn't consider it relevant to the question whether a new public policy established by statute can properly be balanced against the lien right. (The staff is still puzzled why the four-justice majority thought the pay-if-paid provision impaired the mechanic's lien right; this also puzzled the dissenters.) Even if one is convinced by the majority's analysis, the equities involved in the balancing process are different in our situation. In *Clarke* the owner had not paid and the surety company was

trying to get out of paying, whereas the owner who is asked to pay twice has already paid once. *Clarke* can be read more broadly, of course, as an indicator that a majority of the current court will lean very far in favor of mechanic's liens, but as to the impact of the law in the case, the staff doesn't think it has any direct bearing on our question.

Perhaps the discussion wasn't clear concerning the literal scope of the constitutional provision in Memorandum 2000-36 (pp. 3-5). Mr. Abdulaziz finds the point irrelevant. (See Exhibit pp. 3-4.) The point is this: those who contract to provide the services of others are *not* within the constitutional protection. They are not mechanics, material suppliers, artisans, or laborers — the only constitutionally protected classes. If a subcontractor does some "labors," then for the value of that labor, he or she would fall in the constitutional class. These distinctions are real and long-standing. It is not a major point, however, since reform measures, including the Acret proposal, would need to apply to all claimants.

As to the repeated statements that the mechanic's lien is to be liberally construed, we can only say that there is no dispute about that. Probably hundreds of cases have said so, and the staff agrees. But the liberal construction rule (as opposed to the contrary rule that statutes in derogation of the common law are to be strictly construed) is not relevant to the question we are considering. A liberal construction does not lead to a determination of unconstitutionality. Only a balancing of the respective interests can resolve the constitutional issue — measuring a public policy protecting homeowners from having to pay twice balanced against the protection of mechanics, material suppliers, artisans, and laborers in the constitution.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

RESPONSE TO STAFF MEMORANDUM 2000-36

I. INTRODUCTION

This is written in response to Memorandum 2000-36, addressing the constitutionality of the proposed defense for "full payment" to mechanic's liens for owner-occupied single-family residences.[1] As set forth herein, we believe that the Memorandum's conclusion is contrary to the California Constitution. Indeed, we concur with the consultant, Gordon Hunt, and Legislative Counsel, that any Legislative impairment on mechanic's liens would be constitutionally suspect.

II. THE CONSTITUTION GRANTS THE MECHANIC'S LIEN -- ONLY AN AMENDMENT TO THE CONSTITUTION MAY TAKE THE LIEN AWAY

The California Constitution provides:

> "Mechanics, persons furnishing materials, 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." (emphasis added.)

Consistent with that plain language, we believe the Legislature may make laws dealing with the "speedy and efficient enforcement of such liens," but may not abolish lien rights for any class of owners.

III. WHILE THE MEMORANDUM'S RESEARCH IS BROAD, IT GLOSSES OVER THE MOST RECENT COURT DECISIONS WHICH BALANCED THE INTERESTS OF THE PARTIES, FINDING IN FAVOR OF THE "MECHANIC"

At the outset, we commend the breadth of the Staff's research. The investigation and research, as well as the analysis demonstrated in the Memorandum is commendable. However, we believe the memorandum glosses over recent developments of the law, as well as the economic effect on what is proposed. The most recent cases must be given more weight that those determined a long time ago.

A. AFTER BALANCING THE INTERESTS, THE SUPREME COURT HAS MOST RECENTLY RULED THAT MECHANIC'S RIGHTS ARE GREATER THAN THOSE OF THE OWNER TO ITS PROPERTY, AND THAT THE SANCTITY OF THE LIEN CANNOT BE ABRIDGED, EVEN BY

[1] It is not entirely clear that the memorandum's analysis is limited to owner-occupied single-family residences yet the proposal that was discussed involved only such projects.

SOPHISTICATED BUSINESS PERSONS IN AN ARMS' LENGTH TRANSACTION

Our Supreme Court decided only 24 years ago that the Constitutional grant of a mechanic's lien gives the mechanic more rights than the owner. That is to say, where you have two innocent parties, an unpaid subcontractor and an owner who has already paid, the unpaid subcontractor who has put his sweat, materials, etc. into that owner's property should prevail. Connolly Development, Inc. v. Superior Court (1976) 17 Cal.3d. 803.

As with any possible "taking," due process requirements of the Constitution do require notice to owners. That is why the Legislature does have the ability to restrict the lien to those persons who have provided what has been deemed to be sufficient Constitutional notice. The Legislature has promulgated the Preliminary Notice form for just that purpose. That form has been found by the courts over the last half century to meet those constitutional burdens. However, as we discuss in this response, the Legislature does not have the power to completely abolish or abrogate the lien -- it can only limit the enforcement of that lien so that the owner has been afforded due process rights. A literal reading of the Constitutional provision should suffice.

The Memorandum also points out that there has been a trend towards consumer protectionism. However, the Memorandum fails to consider the most recent pronouncement from our highest Court. Most recently in Wm. R. Clarke v. Safeco Insurance Company of America (1997) 15 Cal.4th 882, our Supreme Court was called to rule upon the constitutionality of a condition precedent in a commercial construction agreement. It was argued that the condition precedent was a waiver of constitutionally protected lien rights. The Supreme Court ruled that the parties could not, by contract, waive their constitutionally protected lien rights. The significance of this decision is that these were commercial parties, represented by counsel, who as Safeco argued, had "the freedom to contract" away any rights they had. The Supreme Court disagreed. The Supreme Court balanced two Constitutionally protected rights, the freedom to contract and the Constitutionally protected lien right and found in favor of lien claimants.

In the realm of the small single family residential construction project, the parties are usually not as sophisticated as in the commercial realm. If commercial contractors and developers cannot waive their lien rights because of the sanctity of the mechanic's lien, why should the Staff believe that the residential subcontractor would have any less right to its mechanic's lien rights if the owner paid the contractor?

As recognized by the Supreme Court in Connolly, the exercise of mechanic's lien rights (in Connolly it was the service of a Stop Notice), has an impact upon the owner. The Supreme Court held

that the filing of a Stop Notice as well as the recording of the mechanic's lien deprives the landowner of a significant property interest, and thus constitutes a "taking" within the meaning of the Federal and State due process clauses." Id. at 813-814.

The Supreme Court in Connolly went on to state that there is no question but that the mechanic's lien involves significant state action. Remember that the Constitution only protects persons against State actions. Id. at 815. However, Connolly went on to state that the mechanic's lien and stop notice laws comply with due process requirements. In so holding, the Supreme Court held,

> "In summary, we conclude that the recordation of a mechanic's lien, or filing of a stop notice, inflicts upon the owner only a minimal deprivation of property; that the laborer and materialman have an interest in the specific property subject to the lien since the work and materials have enhanced the value of that property; and that State policy strongly supports their preservation of laws which give the laborer and materialman security for their claims. In measuring these values, we do not deal in cold abstractions. We take into account the social effect of the liens and the interest of the workers and materialman that the liens are designed to protect. We measure these valued interests against the loss, if any, caused to the owner. The balance tips in favor of the worker and the materialman; We conclude that the safeguards provided by California Law to protect owners against unjustified liens are sufficient to comply with due process requirements. We therefore uphold the constitutionality of the mechanic's lien and stop notice laws." Id. at 827-828 (footnotes omitted).

With the words of the Supreme Court in the background, we make our comments.

B. SOME OF THE MEMORANDUM'S COMMENTS ARE IRRELEVANT OR LACK LEGAL SUPPORT

While we applaud the Staff for some of their research, some of it is irrelevant. On page four, the Memorandum states, "subcontractors and sub-subcontractors do not have a constitutionally protected right to a mechanic's lien to the extent they are neither workers (mechanic's, artisans, or laborers) nor material suppliers." We have found no examples of a situation where a subcontractor is not someone who would be providing labor or materials. That is exactly what they do. Remembering that laborers of every class as well as materialmen are specifically enumerated in the Constitution, the discussion seems misplaced.

Similarly, the entire discussion on limitations of the lien to the contract amount or contract price also seems misplaced. First, the Civil Code already does that by Section 3140, which limits the

amount of any lien to the contract price. Such a limitation is not only Constitutional, but was the very basis for the Clarke decision.[2] Secondly, the effect of double payment does not change the contract price. Owners have remedies available to them to protect themselves from making a double payment. Those include conditional and unconditional lien releases, as well as payment and performance bonds.

The limitations on the lien were pointed out by Gordon Hunt, and by Staff in their analysis of the Roystone decision. Roystone Co. v. Darling (1915) 171 Cal. 526. What is interesting is the discussion on pages 17 and 18 of the Memorandum, particularly the statement that the concurring opinion in Roystone (which was relied upon in part by Mr. Hunt in his memorandum) lacks "any notion of balancing the rights of the owner." Connolly in 1976, six decades after Roystone, balanced the interests of the owner (and a construction lender), and ruled the mechanic's lien constitutional.

The Memorandum discussed the Connolly decision in six short lines on page 19, and stated that Connolly "does not tell us the outcome where the Legislature determines that the owner of a single-family, owner-occupied dwelling needs special protection from the risk of having to pay twice." Unfortunately, the reality in today's legal system is that in order to reach an appellate level, a civil case must either have; (1) a substantial dollar amount, (2) an issue which is important to a party (such as an insurance carrier), or (3) an issue important to an association or group who hope to make a change in the law to benefit themselves or society in general. Few, if any, cases involving a mechanic's lien recorded against a single-family residence have a sufficient value to merit appeals. While there have been recent cases involving construction defect litigation that have made it to the Supreme Court, those cases were likely brought by insurance carriers seeking to set precedent.

Staff gives examples of "balanced interests" which were raised by Mr. Acret and Mr. Honda. It was previously stated in Memorandum 2000-9 that the Notice of Nonresponsibility and Preliminary Notice forms are examples of Legislative-enacted "limitations" on mechanic's liens. These are not limitations on mechanic's liens, but are limitations on their impact as to certain persons.

A Notice of Nonresponsibility does not negate lien rights. It only negates them as to "one" owner -- the landowner where tenant improvements are improved. The tenant is also an "owner" of a tenant improvement. The lien applies to that tenant improvement, thus the contractor has some other means of recovery from the real

---

[2] The Supreme Court ruled the "pay-if-paid" clause to be unconstitutional as its effect was to make no amount due on the contract, which pursuant to Section 3140 would make no mechanic's lien valid.

estate that he has improved -- "the leasehold." The Preliminary Notice has been consistently held to be a necessary device to put an owner on notice that a third party may have lien rights against its property. The Preliminary Notice itself does not deprive any lien rights, though failing to properly utilize one will result in the loss of the ability to enforce a lien against the person who did not receive notice. Again, this is not an infringement on lien rights, but is a balancing of interests. This satisfies any due process requirements.

Further, the Notice of Nonresponsibility, which in reality applies only in the commercial realm, is used where more sophisticated contractors and buyers are prevalent. The contractor can look for more credit-worthy owners, and the contractor or subcontractor can also take as large down payment as necessary to assure his or her ability to collect. In the residential market, the contractor is limited, and cannot recover or collect up front from the owner more money than the value of the work already performed. Business and Professions Code section 7159. Clearly, the difference in the type of construction being performed must bear some weight in evaluating the reasons behind the enactment of any particular law or limitation. However, limitations are only allowed to satisfy due process requirements, not to impair lien rights. The Constitution makes it clear that the Legislature "shall" pass laws to provide for the speedy enforcement of lien rights, not to impair those rights.

Staff also discusses the fact that a mechanic's lien does not apply in public works. Let us not forget that as with sovereign immunity, the government can only be sued where and how it consents to be sued. The government has provided a sufficient alternate source for recovery in the form of required public works bonding. One must remember that a payment bond is required on every public work of improvement -- Public Contract Code section 10221 requires the filing of separate performance and payment bonds by the contractor. Civil Code section 3248 requires a bond to be in place equal to one half of the total contract amount on public works. Civil Code section 3251 makes it unlawful for a public entity to make a payment to a general contractor without proof of the filing of an approved payment bond. It is clear that the law has a substitute for the lien on public works in the form of bonding.

It has also been suggested by some that many residential contractors will not be able to obtain a payment bond. Those pundits would argue that the requirement for payment bonds will make residential construction more expensive because only larger contractors who have the wherewithal to obtain such bonds can perform such work, and those larger contractors will pass their greater overhead costs on to the owner. Other arguments would be that there would be a greater incentive for contractors to ignore what is required of them, and take jobs without allowing owners to know of their right to a payment bond.

The reality is, that as with license bonds, if a large number of persons are required to get payment bonds, or the so-called mini payment bond, the costs and availability of such a bond should fall. For that reason, we have proposed that a blanket payment bond in the amount of $50,000.00 be required for anyone doing work on owner-occupied single-family residences. By having a payment bond in force, the contractor will have the alternative source for recovery as with the public works sector, and thus should have the security of not needing to sue the residential owner.

IV. STAFF ERRS WHERE THE MEMORANDUM CONCLUDES THE PROBLEM IS POLITICAL, NOT CONSTITUTIONAL -- THE PROBLEM IS BOTH POLITICAL AND CONSTITUTIONAL

We disagree with the Memorandum's conclusion. Staff deviates from one of its consultant's conclusion, as well as the Legislative Counsel's independent opinion on the constitutionality of such a proposed statute. What happened more than 100 years ago in the Debates and Proceedings, or in the early statutes from 1885 from 1911 are not as relevant as the more recent developments of the law. Clearly, the Connolly court did a balancing and found the lien constitutional, even in the realm where it could mean that an owner has paid twice. As the Supreme Court stated,

> "Turning, second, to the interest of the laborers and materialmen, we note the historical recognition of the importance of these liens. These liens can be asserted only by persons who have contributed labor or supplied material; the claimant has helped to create an improvement which enhances the value of that realty. Explained in the early decision of Tuttle v. Montford (1857) 7 Cal. 358, 360: `The lien of the mechanic, artisan and materialmen, is more equitable, and more favored in law, because those parties have, at least in part, created the very property upon which the lien attaches.'" Id. at 825.

The conclusion of the staff is that there should be no impediment to the Commission "investigating" the Acret approach, as they state that even if wrong they would expect the decision to be 4-3 in the Supreme Court. We disagree. The decision is binding regardless of the margin of victory. Such a risk (losing by a small margin) is not one that the Commission should impose upon the construction industry.

There has been very little discussion of the most recent mechanic's lien case from the Supreme Court either by Mr. Acret or by Staff. In Wm. R. Clarke v. Safeco Insurance Company of America (1997) 15 Cal.4th 882, in which our office participated, the Supreme Court held a contractual provision which made payment by the owner to the contractor a condition precedent to the contractor's obligation to pay the subcontractor, unconstitutional

as a deprivation of constitutionally-protected lien rights. Most recently in 1997 the Supreme Court has reaffirmed that mechanic's lien laws are remedial legislation, to be liberally construed for the protection of laborers and materialmen. Id. at 889.

That case does not center around the constitutionality or unconstitutionality of the mechanic's lien, as did other cases. It does not even center around double payment, as the issue in this instance was an owner's nonpayment. What it demonstrates however is that the mechanic's lien right is so strong that the parties cannot even contract that lien right away. The Staff states that because this decision was a 4-3 opinion, that they could have some persuasion with the Supreme Court. We disagree. Clarke v. Safeco's dissent does not disavow the mechanic's lien right as bestowed by the Constitution. In fact, the dissent states,

> "I agree fully with the majority that the constitutionally protected right of persons bestowing labor or furnishing material on property to "have a lien upon the property" for the value of that laborer or material is fundamental and unwaivable, and that the mechanic's lien laws are to be liberally construed for the protection of laborers and suppliers." Id. at 900 (Dissent of Justice Chin).

The dissent felt that the freedom of contract outweighed the right to a lien in the Constitution.

V. CONCLUSION

In sum, we believe that many of the arguments contained in the Memorandum are misplaced, or are based upon 100-year-old notions that have no place in today's fast-paced economic society. Short of a Constitutional amendment, we see no ability of the Legislature to provide a defense to the mechanic's lien merely because of full payment by the owner. We propose that the mini payment bond, the easier use of joint-control services, or the notice requirements of the HIPP proposals be instituted in place of such a wide ranging proposal. This is true whether the solution is political or Constitutional.

Respectfully submitted,

_____

SAM K. ABDULAZIZ

F:\WP51\LAWREV\MEMO2000.LET