The 21st century began with a real estate decline not unlike the one California experienced in the late 1980s. This article discusses the differences and similarities in how mechanics liens are treated now compared to the late 1980s. It includes a discussion of California’s mechanics lien law in its present form, the efforts of the California Law Revision Commission and pending legislation to revise those laws, and what to expect in the event of the “bankruptcy alternative” and the treatment of such claims in bankruptcy cases.
Pending Revisions to California Mechanics Lien Law and Developments in the Treatment of Mechanics Liens in Bankruptcy

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I. INTRODUCTION

In William G. Murray, Jr.’s article "Workouts in the Twenty-First Century" he writes: "In the late 1980s, the bottom fell out of the real estate market."1 His excellent article discusses the art of workouts in their various forms in light of the withdrawal of the banking industry from its traditional lending role in real estate projects. Until now, his was one of the last articles published in the California Real Property Journal on workouts, bank mergers and failures, and mechanics lien litigation.

This article will discuss the basics of California’s Mechanics Lien law in its present form, the California Law Revision Commission and pending legislation, which would revise the law in accord with the recommendations of the Commission. This article will also discuss how mechanics lien law impacts what the Murray article described as “The Bankruptcy Alternative.” At the time of the Murray article, there were many unresolved questions about what a mechanic had to do to perfect and preserve its status as holding a secured claim against bankruptcy estate property.

Despite amendments in 1994 to the Bankruptcy Code and case law, many questions remain unresolved. In the current real estate downturn, is bankruptcy law more or less favorable to a workout today than in the 90s, especially where mechanics liens are involved? The answer to this question depends on whether mechanics lien claimants can preserve their lien claims, which determines whether the debtor or trustee in a property owner's bankruptcy has to treat those claims as secured or as unsecured contracts for those mechanics in privity with the owner, or not as claims at all against the owner or property of the bankruptcy estate.

When mechanics lien claimants have been fortunate enough to be paid prior to the bankruptcy petition, will they be able to keep the money, or can the debtor or trustee recover the payment under bankruptcy avoiding powers? As is often the case, it depends.2 This article lays out the questions and suggests ways to avoid having to litigate the answers.

II. CALIFORNIA MECHANICS LIEN LAW

While most liens in California follow the “first in time to record is first in priority” rule, the legislature in its wisdom recognized the need for a rule that provides equal fairness to all who provide services for improvement work. In California, mechanics liens have priority from, and they relate back to the date that the improvement work actually began, irrespective of any document having been recorded to trigger the event.

Article XIV, Section 3 of the California Constitution provides that mechanics shall have lien rights and that the legislature shall provide protection for mechanics lien rights. California Civil Code sections 3109 through 3155 respectively set forth the bulk of the statutory law on mechanics liens. Surrounding code sections discuss matters related to the general subject matter beginning with California Civil Code section 3081.01, discussing design professional liens, and conclude with California Civil Code sections 3156 through 3267, regarding stop notices.

The mechanics lien statutes are intended to create an effective enforcement remedy for general contractors, subcontractors, and others who provide labor or services toward the construction or improvement of real property.

A. Summary of Mechanics Lien Process

The significant steps in the mechanics lien perfection and enforcement process include:

1. Commencement of Work: This includes not only the traditional shovel in the dirt, but also the clearing of land, the delivery of materials for the project, or workers on the construction budget clock working at the site.

2. Preliminary 20-Day Notice:3 This notice provides a general description of the labor, service, equipment, price, parties, jobsite, etc. Notice must be provided by a claimant other than “one under direct contract with the owner or one performing actual labor for wages,” no later than 20 days after the claimant has furnished labor or materials to the jobsite to the owner, general contractor, and lender.

3. Notice of Completion:4 This notice must be recorded within 10 days of the completion of the work of improvement. If properly recorded and proved, it has the effect of shortening the lien period within which mechanics liens may be recorded.

4. Notice and Claim of Mechanics Lien:5 The mechanics lien must state the amount of the lien claimant’s demand, less credits and offsets; owner’s name, general statement regarding labor, services, equipment, etc. furnished; name of claimant’s employer, and a site description. The lien binds the property for 90 days from the date of completion and expires unless extended by agreement or a stay.

5. Action Filed: If an action to foreclose the lien has been filed, the subject property will continue to be subject to the lien until the action is dismissed or otherwise terminated.
6. Notice of Action (Lis Pendens) Recorded: The recording of the lis pendens imparts constructive notice of the action and designates the parties by their real names.

7. Service of Process

8. Recordation of Judgment or of Recordation of Release of Lien.

B. California Law Revision Commission Recommendation re: Mechanics Lien Law

The California Law Revision Commission has proposed a complete revision of the California mechanics lien law and associated construction remedies. The Assembly Judiciary Committee requested that the California Law Revision Commission provide the legislature a comprehensive review of the mechanics lien law.

A copy of their report, dated February 21, 2008, is available on the Commission’s website. Senator Lowenthal introduced pending draft legislation following the issuance of the California Law Revision Commission Recommendation relating to mechanics lien law, which may be found in Sen. Bill 1691, as amended. If passed by the legislature and signed into law, the new law will take effect on January 1, 2010.

In its July 12, 2006 Request for Public Comment, the California Law Revision Commission stated: “The recommendation does not propose radical changes to the operation of the existing construction law remedies. The recommendation would simplify, clarify, organize, and modernize the existing statutes. The recommendation includes modest substantive improvements, but it does so in a way that would maintain the relative balance of interests among stakeholders.”


Public work construction remedies will be moved out of the Civil Code and into sections 41010-45090 of the Public Contract Code. The location of the public work construction remedy provisions in the Civil Code was misplaced because there is no mechanics lien remedy available in a public work contract. The remedies available in such contracts are called stop notices and payment bonds, but they differ from similar remedies in private contracts. With the shift to the proposed new section in the Public Contract Code, there will be clarity as well as substantial statutory material governing public work construction contacts, including payment bond and prompt payment requirements.


Prior to 1969, the mechanics lien statutes were located in the Code of Civil Procedure. The California Law Revision Commission has proposed to create a new Civil Code section for mechanics lien law provisions at the end of the Civil Code beginning with new section 8000. This will allow for greater clarity and will avoid future confusion related to the difficulty of amending and expanding the provisions.

3. Terminology Review

The California Law Revision Commission encountered overlong statutes such as Civil Code section 3097 related to the preliminary 20-day notice. This provision, which is the longest of the mechanics lien statutes, having been amended 15 times since 1969, will be re-written and re-located in a new Civil Code section 8200. A number of definitions also were reviewed. For example, the terms “materialman” and “subdivision” are defined in the law but seldom used. The term “site” is also largely ignored in favor of “land,” “real property,” or “jobsite.” Archaic terms such as flumes and aqueducts are included in the definition of “work of improvement.” The California Law Revision Commission’s efforts clean up and systematize the statutory definitions to create consistent usage throughout the mechanics lien law.

4. New Lis Pendens Requirement

Under existing law, it is necessary to file an enforcement action within the statutory time limits of ninety days. The existing law does not require recording a Notice of Action or Lis Pendens to enable others to readily determine if an action has been filed. The proposed legislation would require a claimant who commences an action to enforce a lien claim to record a Lis Pendens disclosing the enforcement action within 110 days of recording the lien claim. If the Lis Pendens is not recorded, the claim of lien expires and becomes unenforceable.

III. BANKRUPTCY ISSUES

The jury is still out on whether or not the current economic climate will result in more owner/builder/developer/contractor bankruptcy filings, or more work outs. For those that have been forced to file bankruptcy proceedings in an effort to preserve their projects, the case law so far seems to indicate that those who hold mechanics lien rights will generally still be protected in bankruptcy court today, provided they have complied with all applicable state law prior to the commencement of the bankruptcy case. However, in the 1980s and 90s, case law highlighted uncertainties as to how the mechanic maintained the mechanic’s secured status during bankruptcy if some of those steps had not been taken before the bankruptcy filing. This created uncertainties for the mechanic and for the debtor or trustee. Despite amendments to the Bankruptcy Code in 1994, which seemed to resolve some of that uncertainty, many of those uncertainties remain despite subsequent case law developments.

Another hot-bed area of mechanics lien law litigation in bankruptcy involves an attempt (usually by a trustee) to recover payments made by the debtor to a subcontractor or material supplier within the ninety days prior to the bankruptcy petition filing; such payments are usually preferential to other creditors of the debtor. The following portion of this article will focus on the types, degrees, and outcomes of such litigation, including defenses the subcontractor or material supplier can and should assert in order to hold on to that precious payment.

A. Maintaining and Perfecting Mechanics Lien Rights in Bankruptcy Cases: The Aftermath of the 1994 Amendments

Assume a simple scenario: a mechanic or material supplier (“mechanic”) has started providing services or goods to a work of improvement, so that the mechanic has an inchoate right to assert a lien on the owner’s property. Prior to the time the
mechanic either has been paid or has perfected its mechanics lien (more on what we mean by that later), the owner files a bankruptcy petition. What may the mechanic do to perfect its mechanics lien and maintain that perfection during the bankruptcy case? What must/may the mechanic do as the bankruptcy case continues in order to be treated as having a mechanics lien? What happens to that mechanics lien claim if the debtor or trustee in bankruptcy seeks court approval to sell the property free and clear of liens, including mechanics liens, during the bankruptcy case?

There are three primary relevant sections of the Bankruptcy Code that address these issues (Title 11 of the U.S. Code). The first are sections 362(a) and (b), governing the automatic stay created by the filing of the bankruptcy petition. Section 362(a) provides in part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(3) any act to create, perfect, or enforce any lien against property of the estate;

(4) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title, or to recover a claim against the debtor that was or could have been commenced before the date on which action is taken to affect such maintenance or continuation.

However, section 362(b)(3) provides that the stay of subsection (a) does not act as a stay of an action to “perfect, or maintain or continue the perfection of, an interest in property” to the extent the interest is subject to perfection under section 546(b) of the Bankruptcy Code:

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate a stay—

(3) under subsection (a) of this section, of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee’s rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title.

Section 546(b) generally permits a party, such as a mechanic, who must take state law action to preserve an interest in property, such as a mechanics lien, to take the substitute action of giving notice under section 546(b). The current text of section 546(b) provides:

(b)(1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that—

(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to affect such maintenance or continuation.

(2) If—

(A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and

(B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition;

such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.

However, under state law, if those steps to maintain the mechanics lien are somehow not covered by the notice alternative provided in section 546(b), section 108(c) may be available to toll the time to take those steps, until the later of 30 days after the section 362 stay has ceased to apply or when the period to act under state law would otherwise have expired.

There are some complicated questions about how these provisions apply to mechanics lien claims, and the answers from case law are uncertain. This uncertainty stems from several causes. First, in 1994 section 362(b) was amended to add the language “to maintain or continue the perfection of,” and section 546(b)(1)(B) was added. Thus, prior to the 1994 amendments, sections 362(b) and 546(b) were construed to address only those steps under state law that were determined to be “perfection” of the lien claim, and not any step that may be necessary under state law to maintain and/or enforce the lien.

Much of the case law preceding the 1994 amendments addressed whether the filing of a mechanics lien foreclosure action was a perfection step (i.e., to maintain or continue perfection of the lien) covered by the notice process of section 546(b), or an enforcement step, and thus covered by the tolling provision of section 108(c). This includes the leading Ninth Circuit decision of Miner v. Hunters Run L.P. (In re Hunters Run) discussed below.