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Didn't My General Contractor Pay You? Subcontractor Construction Liens in Residential Construction Projects

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NOTES

DIDN'T MY GENERAL CONTRACTOR PAY YOU? SUBCONTRACTOR CONSTRUCTION LIENS IN RESIDENTIAL CONSTRUCTION PROJECTS

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I. INTRODUCTION

During the past eight years, the housing market boom carried the United States economy out of the 2000 recession.[1] Due in part to low interest rates for mortgages and home-equity loans, Americans have constructed millions of custom-built homes and renovated their current homes using home-equity loans and lines of credit.[2] Yet what goes up must come down, and over the past two years the housing market has continually declined, leading developers to scrap or downsize construction projects in many markets.[3] In the last three years, the slowing housing market in Florida has led to the demise of numerous general contracting companies, and in the wake of the companies' failures,[4] consumers face construction liens by subcontractors who were not paid by the general contractor.[5] Florida has been hit particularly hard by the slowing housing market, leaving many banks, contractors, and developers short of cash and unable to fulfill their contractual obligations.[6]

In the residential construction industry, homeowners or buyers contract with a general contractor[7] to oversee building or renovations.[8] Acknowledging that the general contractor cannot become an expert in all

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1. Vikas Bajaj & David Leonhardt, *Housing Slows, Taking Big Toll on the Economy*, N.Y. TIMES, July 29, 2006, at A1.

2. John B. Taylor, Remarks at the Policy Panel Symposium on Housing, Housing Finance, and Monetary Policy (Sept. 2007), *available at* http://www.kansascityfed.org/PUBLICAT/SYMPOS/2007/PDF/2007.09.04.Taylor.pdf (discussing the relationship of housing development and construction and the federal funds rate).

3. Bajaj & Leonhardt, *supra* note 1; *see also Before It Gets Better, Florida's Economy Will Get Worse*, SARASOTA HERALD TRIB., July 1, 2008, at D1.

4. *See, e.g.*, Cynthia Barnett, *Left in the Lurch*, FLA. TREND, Aug. 1, 2007, at 58, 58 (describing a failed developer in Port St. Lucie, Florida); Paul Owners, *Work on Hold at Condo Job Site; Developer Misses 3 Deadlines, Angering Buyers*, S. FLA. SUN-SENTINEL, Feb. 23, 2006, at D1 (reporting on construction delays angering homeowners).

5. *See* Barnett, *supra* note 4, at 58.

6. *Id.*; James Thorner, *Another Big Builder Goes Under*, ST. PETERSBURG TIMES, July 30, 2008, at 6B (reporting on the failure of Smith Family Homes and noting that homeowners who recently purchased from Smith Family Homes have received lien notices from contractors).

7. FLA. STAT. § 713.01(8) defines contractor as:

> a person other than a materialman or laborer who enters into a contract with the owner of real property for improving it, or who takes over from a contractor as so defined the entire remaining work under such contract. The term 'contractor' includes an architect, landscape architect, or engineer who improves real property pursuant to a design-build contract authorized by s. 489.103(16).

FLA. STAT. § 713.01(8) (2008).

8. David Weil, *Rebuilding Market Share: Strategic Dilemmas and Institutional Realities in Market Recovery Efforts*, *in* 54 INDUS. REL. RES. ASS'N SERIES. 6, 8 (Paula B. Voos ed., 2002), *available at* http://www.press.uillinois.edu/journals/irra/IRRA_Proceedings_2002.pdf.

facets of construction (and that it would rarely be efficient to do so), the general contractor usually hires subcontractors[9] to complete portions of a construction job.[10] If contractors do not pay the subcontractors, the Florida subcontractor may place a lien on the property to which the work was furnished.[11]

This Note addresses two scenarios: in the first, the buyer contracts with a general contractor to build a home. After paying the contractor and closing on the home, the buyer receives notice that the contractor did not make payment in full to the subcontractors who worked on the home. Current Florida law would allow the unpaid subcontractor to place a lien and foreclose on the buyer's new home if the buyer does not pay the outstanding debts to the subcontractor.[12] In the second scenario, the homeowner hires a contractor to remodel her kitchen. After the homeowner pays a sizeable portion of the project, the contractor walks off the job. Later, the tile subcontractor files a lien against the home, although the kitchen remodel remains unfinished. The homeowner ignores the notice of the lien, fails to pay the amount due, and loses her home when the subcontractor forecloses on the lien.[13] Both these scenarios pose serious risks for Florida homeowners.

Homeowners completing home renovations oftentimes have the most to lose in this cycle for two reasons: first, homeowners may be uninformed of Florida's construction lien laws,[14] and second, the typical homeowner may not have access to sufficient capital to pay off the subcontractor's

9. FLA. STAT. § 713.01(28) defines subcontractor as: "a person other than a materialman or laborer who enters into a contract with a contractor for the performance of any part of such contractor's contract, including the removal of solid waste from the real property. The term includes a temporary help firm as defined in s. 443.101." § 713.01(28). For purposes of this Note, subcontractors and sub-subcontractors are both considered to be subcontractors because they hold virtually identical lien relationships with residential owners. *See* § 713.01(28)–(29).

10. Each of these subcontractors usually works "'on credit,' with the hope that payment will be received when some or all of the work is completed." Ed Glady, Jr., *By Law: Lien Leverage*, REMODELING, May 1, 2006, at 49, 49.

11. James McLoughlin, Annotation, *Right of Subcontractor's Subcontractor or Materialman, or of Materialman's Materialman, to Mechanic's Lien*, 24 A.L.R. 4TH 963 (1983) (surveying the subcontractor and sub-subcontractor's mechanic's lien rights in various states).

12. Note that the buyer has already paid the entire purchase price to the general contractor, and is now forced to pay additional money to the subcontractors which the contractor had already agreed to pay.

13. *See infra* Part II.A.

14. *See, e.g.*, Teresa Burney, *Legislator Wants Stronger Protection for Home Buyers*, ST. PETERSBURG TIMES, Feb. 25, 1995, at B4 (describing proposed legislation to better inform homeowners about the recovery fund available); *It's Time to Change Unfair Mechanics Lien Law*, ST. PETERSBURG TIMES, Oct. 11, 1991, Hernando Times Section, at 2; Ken Moritsugu, *New Law on Liens Hits Homes*, ST. PETERSBURG TIMES, July 1, 1991, Hernando Times Section, at 1 (including Casimer Smerecki's criticism of the then newly passed law arguing that warning only in the notice to owner is insufficient in the residential construction market).

construction liens and pursue legal claims against the general contractor.[15] Homeowners who do not consult attorneys prior to having renovations done may find themselves with a lien on their property, even though the homeowners thought they did everything right.[16]

This Note addresses the current state of Florida's construction lien laws[17] as applied to residential real estate development and renovations in the aftermarket context. In sum, this Note proposes that the Florida Construction Lien Law should provide greater protection from construction liens to residential consumers and homeowners.[18] While contractors and subcontractors need assurance of payment, homeowners alone should not shoulder the risk that subcontractors and materials suppliers may not be paid by contractors.[19] First, this Note discusses the historical precedent and circumstances developing Florida's current construction lien law. Second, this Note analyzes and critique the current Florida construction lien statute's "balance" of the contractor and property owner's interests. Third, this Note reviews residential construction law in Tennessee and Michigan for comparative purposes. Finally, this Note suggests revisions to the current law that will more adequately protect the residential homeowner.

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15. Closing costs on recently purchased homes using conventional mortgages average three percent, plus a minimum of five percent down payment on the home. John L. Goodman, Jr. & Joseph B. Nichols, Note, *Does FHA Increase Home Ownership or Just Accelerate It?*, 6 J. HOUSING ECON. 184, app.198 (1997). Homeowners/buyers who are already highly leveraged may have less than five percent equity in their home, especially given the current downward trend in home prices and further, lenders may be reluctant to loan homeowners money to pay off construction liens.

16. *See, e.g.*, Sallie James, *Construction Law Snags Many Victims*, S. FLA. SUN-SENTINEL, Jan. 26, 1998 at B3. Rudy Melei, a homeowner, received notice from the subcontractor warning him to obtain a written release and warning that Melei could end up paying twice, but "Melei didn't understand the document and ignored it." *Id.*

17. *See* FLA. STAT. §§ 713.001–.37 (2008).

18. As discussed in Part IV, greater homeowner protection from construction liens is the norm in most states, including Tennessee, New York, New Jersey, and Michigan. Michigan and Tennessee are focused on here because Tennessee provides a statute which is virtually the "mirror image" of Florida's current statute in its opposite allocation of risk in construction projects, while Michigan provides a well-balanced comprehensive scheme allocating the risk among all parties in the transaction: the homeowner, contractor, and subcontractor. Moreover, both of these states have well-developed case law addressing construction liens.

19. *See, e.g.*, Jesse Howard Witt, *The Spearin Doctrine and the Economic Loss Rule in Residential Construction*, 35 COLO. LAW. 49, 49 (2006) (noting that in Colorado, "courts have a long history of protecting homeowners from defective construction" and that boilerplate contract language is insufficient to relieve builders from "bear[ing] the risks associated with construction defects . . . [because] professionals . . . are in a much better position to determine the structural condition of a new home than most buyers") (internal citations omitted). Likewise, a similar rule should apply with regard to negotiations between contractors and homeowners—general contractors are in a much better position to negotiate with subcontractors and bear the risk of their own failure to pay subcontractors than most buyers or purchasers of remodeling services.

II. HISTORY OF FLORIDA'S CONSTRUCTION LIEN LAW

Florida's construction lien laws are codified in Chapter 713 of the Florida statutes.[20] All lienors' rights are statutorily created to secure payment for contractors, subcontractors, and materials suppliers and to prevent unjust enrichment of property owners who fail to pay for improvements.[21] The subcontractors' rights to lien have existed in some form since the 1880s,[22] but were not codified by statute until 1963 via the uniform mechanic's lien legislation.[23] The law was revised in 1990 per the efforts of the Lien Law Study Commission, and since then only minor changes have been made to the law.[24]

A. *General Description of Florida's Lien Law*

Florida Statute § 713.06 authorizes subcontractors to attach a construction lien for the amount the subcontractor is owed on any property (except government property) where the subcontractor performed work[25]—so long as the subcontractor has followed procedural guidelines specified in the statute.[26] Only projects with a direct contract price of $2,500 or less are exempt from lien,[27] presumably to keep small-potato remodeling jobs outside of the statute.

Homeowners and buyers, even those who have paid the general contractor in full, must pay the subcontractor's construction lien or risk foreclosure of the lien and sale of the property.[28] Legislatures have offered many reasons why construction liens properly balance the interests of the property owner and the laborer, but most contend that the lien provides security to the laborer or contractor for payment while preventing unjust enrichment of a homeowner who fails to pay for improvements.[29] When a contractor fails to pay subcontractors, buyers can continue with construction or closing,[30] pushing the contractor further into debt and

20. FLA. STAT. ch. 713 (2008).

21. Fred R. Dudley, William A. Buzzett & Deborah Kaveney Kearney, *Construction Lien Law Reform: The Equilibrium of Change*, 18 FLA. ST. U. L. REV. 257, 257 (1991).

22. LARRY R. LEIBY, CONSTRUCTION LAW MANUAL, FLA. PRAC. § 8.01 (West 2007).

23. § 713.06; LEIBY, *supra* note 22.

24. Most of the revisions since the 1991 revisions are stylistic, with the exception of the 2003 warning to owners regarding double payment. *See infra* notes 64–77 and accompanying text.

25. FLA. STAT. § 713.096 (2008); *see supra* notes 7–11 and accompanying text.

26. § 713.06(1); Florida's Construction Lien Law: Protect Yourself and Your Investment, http://www.myflorida.com/dbpr/pro/cilb/documents/florida_lien_law.pdf.

27. § 713.02(5).

28. § 713.06(2)(c).

29. Arthur M. Fowler III, Note, *Lien on Me: An In-Depth Analysis of Tennessee's Mechanics' Lien Statute with Regard to Real Property*, 32 U. MEM. L. REV. 967, 973 (2002).

30. *See* Comment, *Indirect Liabilities of Construction Lenders in a Development Setting*, 127 U. PA. L. REV. 1525, 1538 (1979).

making it even less likely that the contractor will be able to pay the subcontractors.[31] Subcontractors, then, place construction liens pursuant to § 713.06 for unpaid labor and materials, perpetuating a vicious cycle.[32]

The construction lien law, as a harsh remedy, has been interpreted by the courts to require strict compliance by contractors.[33] The Florida Supreme Court held in *Stunkel v. Gazebo Landscaping Design, Inc.*[34] that the construction lien statutes are procedurally strict—failing to follow the procedure exactly fails to place a lien on the property.[35] However, there are no substantive safeguards, except attorneys' fees, to prevent fraudulent liens.[36] Thus, homeowners that did not contract with the subcontractor have little choice but to pay the subcontractor or enter discovery and verify the claim and amount of the lien.[37] The burden of "protect[ing] those persons that the owner knows are on the job" falls only to the owner.[38]

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31. One of the most powerful tools contractors and homeowners have in construction projects is the power to pressure other parties (such as subcontractors) to waive their lien rights. *See* Lynn H. Patton & Krista L. Pages, 2002 A.B.A. Forum on the Construction Industry, Cleaning up After the Dance: How Actual and Constructive Waivers and Releases Can Affect Post-Substantial Completion Claims, 15, *available at* http://www.legalist.com/aba/sf/speakers/pages/pages_patton.pdf. Subcontractors often have to waive lien rights so contractors can get paid by consumers or get dispersal of construction loans. *Id.*

Also, the Federal Deposit Insurance Corporation recommends that banks verify the creditworthiness of developers and contractors prior to agreeing to initiate construction loans; if the general contractor to make payments to creditors, the contractor may not be able to "demonstrate[] the capacity to successfully complete the type of project to be undertaken" and thus may become ineligible for future loans or fund dispersals. FDIC FEDERAL DEPOSIT INSURANCE CORPORATION, RISK MANAGEMENT MANUAL OF EXAMINATION POLICIES § 3.2, *available at* www.fdic.gov/regulations/safety/manual/section3-2.html (last visited Nov. 14, 2008).

32. § 713.06(1); Barnett, *supra* note 4, at 60.

33. Foy v. Mangum, 528 So. 2d 1331, 1333 (Fla. 5th DCA 1988). Strict compliance requires that those wishing to file a lien risk entirely losing their statutory right to the lien by failing to comply with the notice or filing time requirements. *Id.* When a lienor fails to strictly comply with Florida's construction lien statutes, the lien is invalid and should not be recognized. *Id*. The Fifth District Court of Appeal reasoned that if strict compliance were not a necessary prerequisite to foreclosure of a construction lien, it could "lead[] to confusion in an area of the law which can least tolerate uncertainty." *Id.* at 1334.

34. 660 So. 2d 623 (Fla. 1995).

35. *Id.* at 625.

36. *See id.* (holding that the lien law should be strictly construed, particularly regarding timeliness).

37. This system is particularly difficult if the general contractor has filed for bankruptcy protection, become delinquent, or simply "walked off the job." Homeowners may have few opportunities to gain information about the subcontractor or even to verify that the amount due actually belongs to the homeowner's particular home in large-scale developments. This also applies with great urgency to liens by "materialmen" or suppliers who may provide supplies to numerous houses, yet the general contractor may have incorrectly applied payment, or the supplier may file a lien on the wrong home. *See* Fred R. Dudley, *Florida Construction Liens: Representing the Residential Owner*, 79 FLA. BAR J. 34, 35 (2005).

38. H.R. STAFF ANALYSIS, H.B. 681, 1999 Regular Session. "Typical examples of a person on the job without direct contact with owner are subcontractors and material suppliers. The lien law

The statute also allows courts to apply multiples to attorneys' fee awards, which are determined at the court's discretion. In *Michnal v. Palm Coast Development, Inc.*,[39] the Fourth District Court of Appeal held that while the construction laws authorize awarding multipliers of attorneys' fees, a trial court must weigh numerous factors, as set out by the Florida Supreme Court, when determining whether to add the multiplier to the attorneys' fees.[40]

In *Standard Guaranty Insurance Company v. Quanstrom*,[41] the Florida Supreme Court ruled that in tort and contract cases, a court should weigh the following factors when determining whether a multiplier is necessary:

> (1) whether the relevant market requires a contingency fee multiplier to obtain competent counsel; (2) whether the attorney was able to mitigate the risk of nonpayment in any way; and (3) whether any of the factors set forth in *Rowe* are applicable, especially, the amount involved, the results obtained, and the type of fee arrangement between the attorney and his client. Evidence of these factors must be presented to justify the utilization of a multiplier.[42]

Under this test, even homeowners who contest a lien in good faith may be subject to fee multipliers.[43]

Finally, Florida's current law contains a "proper payment defense."[44] This defense entitles a homeowner to financial exposure limited to the amount on the total contract with the general contractor, but only if the homeowner verifies that *each lienor* in privity with the contractor has been paid after *each payment*.[45] While the proper payment defense would prevent homeowners from paying twice for subcontractors' labor and materials,[46] the vigilance required to verify every payment to every subcontractor is unrealistic for residential consumers.

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requires these parties to give the owner formal notice that they are on the job. Once a subcontractor or material supplier has given the owner notice, the owner is required to see to it that that person is paid." *Id.*

39. 842 So. 2d 927 (Fla. 4th DCA 2003).

40. *Id.* at 934.

41. 555 So. 2d 828 (Fla. 1990).

42. *Id.* at 834.

43. If a homeowner retains an attorney to dispute a lien that the homeowner believes is fraudulent and loses the case, the homeowner is likely expending the same funds which could be used to have simply paid the lien in the first place. With the addition of fee multiples, the homeowner is at even greater risk of losing the home because they may no longer have the money to pay the judgment in the amount of the lien plus attorneys' fees and cost multiples.

44. *See* Deborah H. Lawson, *Florida's Construction Lien Law: How It Works and What NACM Has Done to Strengthen It*, 102 BUS. CREDIT 60, 61 (2000).

45. *Id.*

46. *Id.*

B. *Legislative History*

Because of public outcry as well as lobbying from the construction industry, the Florida Legislature voted to establish the Mechanics' Lien Law Study Commission in 1989.[47] The Commission was created to: educate the public; encourage the recordation of the Notice of Commencement; review the effectiveness of criminal, civil, and administrative remedies; study a lien recovery fund; review the effectiveness of notice requirements; determine the scope of lender responsibility; and review the scope of exemptions under the lien law.[48]

The Commission's findings, suggested revisions, and report to the Governor are codified in Florida law.[49] The Commission proposed renaming the liens from Mechanics' Liens to Construction Liens to prevent confusion,[50] and also attempted to "simplify[] the lien law—at least as it applies to non-developer residential construction."[51] Overall, the Commission proposed a wide variety of changes to the provisions of Chapter 713,[52] though only two of these changes directly applied to the relationship between subcontractors and owners.[53] Also, the Commission amended Florida Statute § 713.31 to clarify that asserting that a lien is fraudulent is a complete defense, but that "a minor mistake or error [in a claim of lien,] or a good faith dispute as to the amount due does not constitute a willful exaggeration that defeats an otherwise valid lien."[54]

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47. *See* 1989 Fla. Laws 2451; Dudley, Buzzett, & Kearney, *supra* note 21, at 259. The Governor of Florida, President of the Senate, and the Speaker of the House of Representatives were charged with appointing various members of the Commission. 1989 Fla. Laws 2451.

48. *See* 1989 Fla. Laws 2452.

49. 1990 Fla. Laws 109. Fred Dudley chaired the committee and prepared the report for the Governor. Holland & Knight, Biography for Frederick R. Dudley, http://www.hklaw.com/id77/extended1/biosFRDUDLEY/ (last visited Nov. 14, 2008).

50. On the concern that the general public might associate mechanics' liens with automobiles rather than liens for work performed on real property, the Commission suggested that the term construction lien would better convey the statute's relevance to consumers. LEIBY, *supra* note 22.

51. Ken Moritsugu, *Mechanics' Lien Law May Be In for An Overhaul*, ST. PETERSBURG TIMES, Oct. 22, 1989, at I1.

52. *See id.*

53. Changes to Florida Statute § 713.06 included changing "shall" to "must" throughout the statute and also revising the warning phrase on the notice to include both: "WARNING TO OWNER: UNDER FLORIDA LAW, YOUR FAILURE TO MAKE SURE THAT WE ARE PAID MAY RESULT IN A LIEN AGAINST YOUR PROPERTY AND YOUR PAYING TWICE" and "TO AVOID A LIEN AND PAYING TWICE, YOU MUST OBTAIN A WRITTEN RELEASE FROM US EVERY TIME YOU PAY YOUR CONTRACTOR." 1990 Fla. Laws 307–08 (codified as amended at FLA. STAT. § 713.06(2)(c) (2008)).

Florida Statute § 713.13 was amended to provide a form for the notice of commencement that owners and contractors must file with the clerk's office prior to beginning construction. § 713.13(1)(d). Also, the time "window" to begin the construction after filing the notice of commencement was extended from thirty days to ninety days. § 713.13(2).

54. 1990 Fla. Laws 309 (codified as amended at § 713.31(2)(b)).

Finally, the Commission increased the penalties contractors faced for misappropriation of construction funds from those for a misdemeanor charge to a felony, regardless of the amount misappropriated.[55] In general, criminal sanctions may apply to contractors who misappropriate funds, but the standard is rigorous—requiring willful, knowing, or intentional misconduct.[56] Because the standard for criminal charges is high, the probability of being convicted of criminal misappropriation of funds is low. Only in the most egregious circumstances are contractors prosecuted for misappropriation of funds.[57] In general, while the criminal penalties for misappropriation were raised, the 1990 amendments did not significantly change the owner's right to dispute a lien.[58] For the most part, the 1990 changes only increased the "hoops" that contractors and subcontractors were required to jump through to place the lien, rather than providing protection to ensure contractors actually pay their subcontractors.[59]

Historical precedent is one possible reason Florida turned toward protecting contractor interests in the late 1980s and early 1990s. During this period, housing was big business in Florida, and studies of state lobbying registrations in the 1980s and 1990s suggest that Florida had significantly more interest groups than any other state, including pro-contractor lobbyists.[60] In fact, the number of construction lobbyists registered in Florida increased approximately 160% from 1980 to 1990.[61]

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55. 1990 Fla. Laws 309 (codified as amended at § 713.345). The statute divides the felonies by degree according to the amount of money involved: if the amount was greater than $100,000 then the contractor was guilty of a first-degree felony. § 713.345(1)(b)1. Misappropriation of any amount between $100,000 and $20,000 was a second-degree felony, FLA. STAT. § 713.345(b)(2) (1990), and misappropriation of any amount less than $20,000 was a third-degree felony. *Id.* § 713.345(b)(3).

56. Youngker v. State, 215 So. 2d 318, 321 (Fla. 4th DCA 1968); 36 FLA. JUR. 2D *Mechanics' Lien* §§ 172–173 (2008).

57. *See infra* Part III. The *Andres* case is one of the best examples of criminal prosecution, discussed *infra* notes 96–97.

58. The owner may move to dismiss the lien because of defects in procedure, but cannot simply allege that the contractor has been paid to dismiss a suit. *See* Stunkel v. Gazebo Landscaping Design, Inc., 660 So. 2d 623, 625 (Fla. 1995) (holding that lien law is a creature of statute and thus must be strictly construed).

59. *See* 1990 Fla. Laws 314.

60. Holly Brasher, David Lowery, & Virginia Gray, *State Lobby Registration Data: The Anomalous Case of Florida (And Minnesota Too!)*, 24 LEGIS. STUD. Q. 303, 303–04 (1999) (noting that Florida had previously been considered such an outlier in evaluating lobbyist registration that many statistical analyses of lobbyists during the period simply discarded Florida from analysis). While Brasher, Lowery, and Gray theorize that the 1994 data overcounts lobbyists in the early 1990s based on a change in Florida's definition of "lobbyist" and thus a change in the "net" of those to whom the registration statute applied, the authors recognize that prior to the change in lobbyist registration procedures, Florida still had significantly more lobbyists than comparable states. *See id.* at 307–08.

61. *Id.* at 311 (counting a change in raw total of construction lobbyists from 48 in 1980 to 125 in 1990).

While any inference that the increased number of construction lobbyists correlated to a favorable change in construction laws for contractors would be based on inductive reasoning at best, such a result is at least plausible.

Members of the Florida Legislature tried a few times (unsuccessfully) in the early 1990s to add more consumer protection.[62] Most notably, State Representative Paul Hawkes lobbied on numerous occasions to exempt single-family homes and duplexes from construction liens that would require homeowners to pay twice for a subcontractor's work.[63] The first attempts at reform occurred in 1989, when a bill was introduced which would have exempted homes costing $150,000 or less[64] from non-privity mechanics'[65] lien law.[66] Representative Hawkes again attempted to revive the exemptions for single-family homes in 1991 but was again unsuccessful.[67] Other changes proposed in 1991 by the Mechanic's Lien Commission were adopted, but the adopted changes fall far short of protecting homeowners from double payment.[68] Between 1991 and 1998, no major changes to the construction lien law were proposed which would directly affect the rights of subcontractors and non-privity lienors.

Numerous changes to the non-privity construction lien statutes were made in 1998.[69] For example, the manner of service sufficient to give notice to an owner was changed so that simply placing the notice in the mail to the proper owner established the service date as the date of mailing.[70] Prior to this change, registered mail was required to effect

62. James, *supra* note 16 ("State Rep. Jack Tobin . . . said legislators have tried unsuccessfully for years to get the law taken off the books but the construction lobby in Tallahassee has made it difficult.").

63. *See* Ken Moritsugu, *Legislator Seeks Equity in Lien Law*, ST. PETERSBURG TIMES, Oct. 10, 1991, Hernando Times Section, at 1.

64. In 1990, the Florida median home sales price was $77,100. U.S. Census Bureau, Historical Census of Housing Tables, Home Values, http://www.census.gov/hhes/www/housing/census/historic/values.html. Therefore, the vast majority of Floridian homeowners would have been exempt from construction liens if the bill had passed without revisions, excepting only those with houses costing almost twice the median home value. *See* Moritsugu, *supra* note 63. Adjusted for inflation to year of 2000 prices, the proposal would have exempted houses costing less than approximately $191,000 (the equivalent of $150,000 in 1990, accounting for a 27% inflation adjustment between 1990 and 2000). *See* U.S. Census Bureau, Historical Census of Housing Tables, *supra*. Because the bill only would have exempted homes costing less than $150,000, it would shift the risk of construction liens away from those least likely to be able to afford a lien or the cost of a lawsuit. Such a law also would have been sufficiently tailored to protect only property owners with modest incomes.

65. Now referred to as the construction lien law after the 1991 amendments as FLA. STAT. Ch. 713. *See supra* note 50 and accompanying text.

66. *See* Moritsugu, *supra* note 63.

67. *Id.*

68. *See* Dudley, *supra* note 37, at 34.

69. *See* FLA. STAT. § 713.01 (1998).

70. Larry R. Leiby, *1998 Changes to Public Works Bonds and Construction Lien Law*, 73 FLA. B. J. 36, 40–41 (1999).

service, a requirement that lienors claimed was too costly.[71] Under the new system, lienors could mail notice within forty days of providing services and a postal worker could stamp a mail log maintained by the lienor.[72] A mail log stamp would suffice to prove date of notice.[73] The effect of this legal change is that a postal worker may not adequately check that the property owner's address matches the address listed in the mail log, creating proof of service where the owner did not receive notice.[74]

In 2003, the Florida Legislature passed a bill requiring that all notices of commencement contain the following disclosure:

> "WARNING! FLORIDA'S CONSTRUCTION LIEN LAW ALLOWS SOME UNPAID CONTRACTORS, SUBCONTRACTORS, AND MATERIAL SUPPLIERS TO FILE LIENS AGAINST YOUR PROPERTY EVEN IF YOU HAVE MADE PAYMENT IN FULL."[75]

House of Representatives staff analysis indicates that "[i]n order to avoid double payment, the owner must make sure that the person giving the notice has been paid before making any payments to the contractor and can require the contractor to provide lien waivers from subcontractors or suppliers who have served a Notice to Owner."[76] Some scholars believe this revision to the statute should have been enacted concurrently with provisions that made homeowners liable for any non-privity construction liens.[77]

III. CRITIQUE OF CURRENT LAW

Florida's current construction lien law is insufficient to protect the interests of homeowners, many of whom will only be involved in one construction dispute during their lifetimes.[78] Though the law attempts "to contain a rational and fair method for balancing the right of both sides[,]"[79] the current law is simply better suited to commercial property owners and

71. *See id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. H.B. 1719, 105th Leg., Reg. Sess. (Fla. 2003). The added text further clarifies that to prevent being liable for double payment, the owner must obtain written release from lien *every time* the contractor is paid. *Id.*

76. H.R. STAFF ANALYSIS, H.B. 1719, 2003 Regular Session.

77. *See* Dudley, *supra* note 37, at 34 n.9 (stating that "some may contend that such a warning [of the homeowner's potential double liability] is 'a little late' . . . .").

78. *See id.* at 34–35 (noting that most owners are completely naïve regarding their rights in construction disputes and therefore would be best served by closely following the advice and supervision of their attorneys).

79. H.R. STAFF ANALYSIS, H.B. 681, 1999 Regular Session.

developers. The law shifts to the property owner the entire economic risk of the contractor defaulting on the subcontractors' payments. The current law also subjects the property owner to potentially fraudulent liens from subcontractors and forces the property owner to negotiate with subcontractors for services they did not expressly authorize.

A. *Economic Risk of Construction Liens for Homeowners*

Consumer advocates complain that the current construction lien statute is unfair and anti-consumer for two reasons.[80] First, the law makes the homeowner liable for payment to subcontractors with whom she was never directly involved.[81] Second, "the law induces unpaid subcontractors to go after the homeowner instead of the real guilty party: the builder who has reneged on his agreement with the subcontractor."[82]

Ironically, Florida provides greater protection for homeowners against liens based in state creditor's remedies than in construction payment disputes. Florida's state homestead exemption statute prohibits creditors with a judgment from filing liens on a debtor's primary residence.[83] It seems incongruous that Florida should provide so much protection from liens on a person's home for valid judgments issued by a court yet not protect the homeowner from paying twice for home improvements.[84] If the legislative intent of the Florida Constitution's exception clause is to prevent the homeowner from receiving a windfall from home improvements, this intent is not adequately served by allowing subcontractor's liens for improvements already paid for by the homeowner. Construction liens by subcontractors where homeowners have

80. Moritsugu, *supra* note 51. Though the law has been amended since this article's publication, the revisions of the law in this area are not substantive and have not changed consumer advocates' opinion that the law is pro-contractor.

81. *Id.*

82. *Id.* (quoting Casimer Smerecki, chair of the Citrus County task force on building practices in 1988, as stating, "[t]he law is anti-consumer.").

83. FLA. CONST. art X, § 4(a)(1) ("There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person: (1) a homestead . . . ."); *see* Richard M. Hynes, *Broke But Not Bankrupt: Consumer Debt Collection in State Courts*, 60 FLA. L. REV. 1, 8 & n.33 (2008). Even the Internal Revenue Service is prohibited from seizing a home when the amount due is less than $5,000. Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Paradigm Shift in the IRS Restructuring Act of 1998*, 56 FLA. L. REV. 1, 118 (2004).

84. In *Milton v. Milton*, the Florida Supreme Court stated that "[o]rganic and statutory provisions relating to homestead exemptions should be liberally construed in the interest of the family home." 58 So. 718, 719 (Fla. 1912), *overruled in part by* Pasco v. Harley, 75 So. 30, 32 (Fla. 1917) ("[P]rovisions of the homestead laws should be carried out in the liberal and beneficient [sic] spirit in which they were enacted, but at the same time great care should be taken to prevent them from becoming the instruments of fraud.").

been asked to pay twice should not jeopardize the homestead.[85]

Florida statutes place the burden on property owners to be sure that those subcontractors they know are on the job are paid.[86] Contractors and construction experts recommend that consumers "check[] the builder's creditors, suppliers, subcontractors, banks and former customers."[87] However, this requirement is unrealistic for the residential owner, who is generally unsophisticated and may not be in a position to closely monitor construction.[88]

Disputes over construction liens placed by contractors may in extreme cases lead to foreclosure of the home. There are numerous examples of subcontractor-homeowner disputes leading to foreclosure where the homeowner paid a contractor and a subcontractor's lien was subsequently filed on the home.[89] The current law requires the same construction lien process regardless of whether the property owner is a sophisticated commercial developer or a residential homeowner.[90]

B. *Economic Risk for Subcontractors*

While the homeowner should be protected from construction liens, it is important to note that subcontractors are often in a precarious financial position and can just as easily be left on the hook by the contractor for unpaid charges.[91] Subcontractors are often intimidated by contractors to abstain from filing the notices necessary to later enforce their lien rights.

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85. If the homestead exemption applied to bar construction liens on residential property, subcontractors could bring suit and become judgment creditors of either the homeowner or the contractor. As such, they could levy on any non-exempt property, which in Florida includes almost all property except the homestead, placing construction lien creditors on equal footing with all other unsecured creditors.

86. *See supra* notes 44–48 and accompanying text.

87. Lynn Yoffee, *Get to Really Know Your Builder, or Face the Consequences*, ORLANDO SENTINEL, July 21, 1990, Lake Sentinel Section, at 11. Ironically, Granger, the expert consulted in this article, suggests that while home buyers should investigate the contractors and subcontractors prior to agreeing to build the home, homeowners should not contact the subcontractors to investigate any concerns they have about the home's construction. While this may prevent disagreements between the subcontractors and the buyers, it also provides a strong argument that homeowners should not be directly liable to subcontractors when the project goes south; contractors that request homeowners do not contact the subcontractors should bear the risk of ensuring subcontractors are paid rather than the homeowners.

88. *See, e.g.*, Robert Keefe, *The Work of Many Hands*, ST. PETERSBURG TIMES, Aug. 14, 1994, at H1 (discussing the circumstances of John and Debbie Pitcairn, who live "hundreds of miles away" from the home they contracted with Hannah-Bartoletta Homes to build in Tampa).

89. *See* Barnett, *supra* note 4, at 58, 61 (commenting on the Great Bay Homes bankruptcy and more than fifty homes abandoned by Great Bay's developer, David Wesley Vickers).

90. Florida bills were proposed in 1998 which tried to establish separate standards for homeowners and commercial/developers, regarding both notice and also procedure. *See* Leiby, *supra* note 70, at 39–40.

91. Marianne Jennings, *Quantum Meruit Rises Again*, 32 REAL EST. L.J. 272, n.11 (2003).

While the subcontractor is often vulnerable to the financial difficulties of the contractor, many states other than Florida protect subcontractors by allowing the subcontractor to sue the homeowner for unjust enrichment rather than filing liens that could force sale of the home.[92]

Subcontractors may seek local remedies by filing a complaint with the county construction board against the contractor.[93] However, this approach is inadequate to protect the subcontractor's interests because the most common remedy is suspending the contractor's licenses—a measure that is more likely to increase a contractor's "cash crunch" and actually reduce the possibility for payment, since the contractor may not be able to complete current projects and collect payment.[94] In some cases, contractors are suspended from obtaining building permits, which essentially puts the contractor out of business.[95] In these types of situations, state agencies such as the Department of Professional Regulation and the local state attorney's office may also investigate for cases of fraud or misappropriation of funds[96] and press their own fines and charges independent of the county's penalties.[97] But the system still does not reimburse subcontractors for their unpaid bills even when it becomes clear that the contractor will not profit from construction due to the licensing and permitting failures.

C. *Florida Homeowners' Construction Recovery Fund: Shifting Risk to Taxpayers*

The Florida Homeowners' Construction Recovery Fund provides a last resort from which homeowners can recover when contractors mismanage funds,[98] and the fund may provide relief if a subcontractor files a lien.[99]

92. *Id.* at 272. Jennings suggests that quantum meruit should only be applied in jurisdictions where homesteads are exempt from mechanic's liens by subcontractors, and only when the court finds it necessary to prevent a windfall to the property owner who has not paid the general contractor. *Id.* Finally, Jennings notes that the subcontractor may be better equipped than homeowners to analyze the creditworthiness and reputation of contractors. *Id.*

93. *See generally, e.g.*, Robert Keefe, *Foundation Shaky for Andres*, ST. PETERSBURG TIMES, Oct. 29, 1990, Hernando Times Section, at 1.

94. *See* Robert Keefe, *Home Builder Arrested on Charges of Organized Fraud*, ST. PETERSBURG TIMES, Apr. 1, 1992, Hernando Times Section, at 1.

95. *See generally* Robert Keefe, *County Suspends Builder's Privileges*, ST. PETERSBURG TIMES, Nov. 15, 1990.

96. As occurred in the *Andres* case, where Gerald Andres was charged with organized fraud in Hernando County, Florida. *See generally* Keefe, *supra* note 94. In 1992, the Department of Professional Regulation issued an emergency order suspending Andres' building license throughout Florida. Shortly thereafter, Andres filed for bankruptcy protection. *Id.*

97. *Id.*

98. David George, a lawyer and lobbyist for the American Subcontractors Association's Suncoast Chapter, analogizes the contractor's industry to a "proverbial house of cards . . . . [Home builders] are using money from one job to fund another. It's common. When they get into trouble and get hung up on one job, then everything starts to fall." Denise L. Amos, *The Pay-as-you-go*

The Construction Recovery Fund was established as part of the Florida Department of Business and Professional Regulation's efforts to compensate property owners for losses they may sustain due to mismanagement by contractors. The board, composed only of contractors, allows property owners to make claims of the fund only after obtaining a judgment against the contractor in civil or criminal court, or as a result of an arbitration proceeding.[100] However, the fund is only meant to be a last resort for property owners who cannot otherwise satisfy their judgment against the contractor.[101]

While the Fund does provide relief for some property owners, the current system is inadequate for two reasons. First, the award amount is determined by the board (rather than by the amount of the court's or arbitrator's judgment) and is capped at either $25,000 or $50,000, depending on when the claim arose.[102] Second, and particularly concerning in the residential consumer context, the fund does not cover any attorneys' fees.[103] Many homeowners may choose to abandon a valid claim against a contractor because the attorneys' fees necessary to obtain a judgment against the contractor may exceed the amount of the lien. Further, the fund is operated by a panel of construction experts with no input from consumer protection groups.[104]

IV. SURVEY OF SIMILAR STATUTORY PROVISIONS FROM OTHER JURISDICTIONS

At least two states have enacted statutory reforms that protect homeowners more adequately than Florida's current construction lien statutes. Tennessee was the first state to enact legislation preventing subcontractor's liens on owner-occupied one- or two-unit residences.[105] The second, Michigan, does not prohibit non-privity construction liens on

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Lien Falls Short, ST. PETERSBURG TIMES, Dec. 15, 1991, at 1I (alteration in original).

99. Florida Department of Business & Professional Regulation, Frequently Asked Questions Regarding the Recovery Fund For the Construction Industry Licensing Board at 2, http://www.myflorida.com/dbpr/pro/cilb/documents/recov_faqs.pdf (last visited Nov.14, 2008).

100. *Id.* at 4.

101. *Id.* at 1.

102. *Id.* at 2.

103. *See id.* at 2.

104. Florida Department of Business & Professional Regulation, Construction Industry Licensing Board, http://www.myflorida.com/dbpr/pro/cilb/index.html. The Construction Licensing Board maintains the panel hearing construction mismanagement claims. *Id.*

105. TENN. CODE ANN. § 66-11-146(a)(2) (1991). The law's intent was to protect homeowners in single-family homes and duplexes from construction liens by non-privity contractors. While the substance of the law has not been altered since its enactment in 1991, the law has been expanded to include three-unit and four-unit residences as well, indicating Tennessee's objective to eliminate *all* non-privity construction liens on the residential market and strengthen consumer protection. TENN. CODE ANN. § 66-11-146(a)(2) (2008).

owner-occupied residences, but does require more "red tape," including a requirement that subcontractors attempt collection from other sources before foreclosing the lien.[106] This Part will describe and analyze the benefits and disadvantages of adopting statutes similar to Tennessee's or Michigan's, as well as evaluating whether these statutes effectively accomplished their respective goals.

A. *Tennessee Code § 66-11-146*

Tennessee's indirect mechanic's lien statute bars a subcontractor from placing a lien on residential real property as defined in Tennessee Code § 66-11-146(a)(1).[107] By enacting the statute in 1990, Tennessee legislators intended to protect a homeowner from "being surprised by or subjected to liens against his property."[108] Essentially, the 1990 revision was enacted to prevent making homeowners pay twice for repairs.[109] A Tennessee legislator proposed the change prohibiting contractors from placing liens on residential property after a lien was placed on his own property.[110] Prior to 1990, Tennessee's statute did not distinguish by the type of property (residential or commercial).[111]

The Tennessee statute is fairly harsh, prohibiting subcontractors from placing construction liens on residential property even where the contractor has complied with the law, or when the homeowner has not paid the entire amount due on the contract.[112] The statute is also arguably overbroad, applying to properties which are intended to be residential and to "spec" houses, even when the owner of the property does not intend to live in the home.[113] In sum, the Tennessee statute may overprotect some residential property owners that do not need protection from

106. *See* Bank One v. Holsbeke Constr., Inc., No. 268251, 2007 WL 2781046, at *4 (Mich. Ct. App. Sep. 25, 2007).

107. § 66-11-146; 16 WILLIAM H. BROWN, NANCY FRAAS MACLEAN & LAWRENCE R. AHERN, TENNESSEE PRACTICE SERIES, DEBTOR-CREDITOR LAW & PRACTICE § 3:12 (2d ed. 2008).

108. Fowler, *supra* note 29, at 995–96.

109. "The principal legislative purpose in enacting § 66-11-146 appears to have been to address the situation in which a homeowner, having already paid a general contractor for an improvement, had liens filed against his residence by subcontractors and material suppliers who have not been paid in full by the general contractor, in effect being forced to pay again for the same service or material in order to remove the encumbrance." Tenn. Op. Att'y Gen. 91-114 (1991), 1991 WL 535047, at *9 & n.6.

110. *Subcontractor May Put Lien on Your Home*, ORLANDO SENTINEL, July 14, 1990, at G4. Tennessee was the first state in the nation to ban subcontractors from placing liens on residential homes and prevent homeowners from paying twice for improvements. *Id.*

111. Tenn. Op. Att'y Gen. 91-114, *supra* note 109, at *4.

112. "[T]he provisions . . . appear to apply irrespective of a general contractor's compliance with the Contractor's Licensing Act . . . ." *Id.* at *10.

113. "[T]here is no requirement under [§ 66-11-146] subdivision (b)(1) that the owner of the property intend to reside on the property." *Id.*

subcontractors, namely the developer of "spec" houses,[114] a situation that could potentially allow developers to manipulate the statute. Also, the statute does not protect subcontractors even where they may have a valid claim for payment, forcing subcontractors to become unsecured creditors of the contractor with little hope of redress if the contractor files for bankruptcy protection.[115]

B. *Michigan's Statute § 570.1203 and Homeowner's Construction Lien Recovery Fund*

Michigan developed a comprehensive scheme to protect both homeowners and subcontractors from suffering losses at the hands of general contractors. This protection is accomplished through two separate "prongs": Statute § 570.1203 to protect homeowners, and the Lien Recovery Fund to protect subcontractors.[116] Michigan protects homeowners from claims of unlicensed contractors and from paying twice for a job.[117] However, in *Gould v. Lewicki*,[118] a Michigan appellate court reiterated that full protection from construction liens is only available when the owner has paid the general contractor *in full*.[119]

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114. "Spec" or speculative houses are homes "built, done, bought, etc., as a speculation." Dictionary.com, http://dictionary.reference.com/browse/spec; *see* Comment, *Liability of the Institutional Lender for Structural Defects in New Housing*, 35 U. CHI. L. REV. 739, 742 (1968) ("The other segment of the industry is frequently termed 'speculative' building because the builder normally does not contract with purchasers before construction . . . ."). Essentially, spec homes are homes built by a developer without a buyer's contract.

115. Some case law suggests that even when a contractor is guilty of misappropriating funds, subcontractors and consumers may not get an equitable lien on the contractor's property that would entitle the creditor to a security interest, because misappropriated funds "could not serve as the basis of an equitable lien. . . ." Jeffrey Davis, *Equitable Liens and Constructive Trusts in Bankruptcy: Judicial Values and the Limits of Bankruptcy Distribution Policy*, 41 FLA. L. REV. 1, 42 (1989).

116. MICH. COMP. LAWS § 570.1203 (2008). The statute provides in relevant part that:

> (1) A claim of construction lien does not attach to a residential structure, to the extent payments have been made, if the owner or lessee files an affidavit with the court indicating that the owner or lessee has done all of the following: (a) Paid the contractor for the improvement to the residential structure, indicating in the affidavit the amount of the payment . . . . ; (b) Not colluded with any person to obtain a payment from the fund; (c) Cooperated and will continue to cooperate with the department in the defense of the fund.

Id.

117. Lawrence E. Dudek & Marilynn K. Smyth, *Construction Liens: How Lien Law in Michigan Affects Commercial and Residential Property*, 82 MICH. BAR J. 26, 29 (2003).

118. No. 263200, 2006 WL 3754803 (Mich. Ct. App. Dec. 21, 2006).

119. *Id.* at *2. The court held that Lewicki's defense to the construction lien was invalid because only $178,061.58 of the $255,200.00 contract price had been paid to the contractor, also noting that the statute's purpose was to "provide for the payment of subcontractors and suppliers,

To file any lien on residential property, lienors must follow procedures above and beyond those required for commercial property construction.[120] First, contractors intending to file a lien must have a written contract with the consumer containing procedural safeguards, such as notifying the consumer that a contractor must be licensed and providing the contractor's license number.[121]

Second, Michigan created the Homeowner Construction Lien Recovery Fund to protect homeowners who had paid a contractor in full from being liable for construction liens to unpaid subcontractors.[122] Michigan's legislature recognized that while residential construction liens should not be abandoned entirely, homeowners should be protected from paying twice.[123] The mechanics of the recovery fund are straightforward. Generally, when applying for a contractor's or subcontractor's residential construction license, each applicant must pay a $50 fee to the Construction Lien Recovery Fund.[124] However, after the fee is paid, a lien claimant is a member of the fund forever and may apply to collect unpaid fees from the fund in lieu of filing a lien against the homeowner.[125]

To qualify for protection, homeowners must have paid the contractor and declare that they have not colluded with others to obtain payment from the fund.[126] A Michigan appellate court held in *Erb Lumber, Inc. v. Gidley*[127] that the proper analysis is whether the homeowner has paid for the portion of the job related to the subcontractor's lien, not whether the entire project has been paid to the subcontractor.[128] Michigan's attorney general administers any claims on the fund.[129] Additionally, a payout from the recovery fund is limited to $100,000 per residential structure, regardless of the number of unpaid subcontractors; if claims against the home are greater than $100,000, the subcontractors share pro rata.[130]

In 2006, the Michigan Construction Lien Act was amended to include new notification requirements for lienors.[131] Then in 2007, the Michigan Construction Lien Act was amended again to require that: "a[] [residential]

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but also protect[] homeowners from paying twice." *Id.*

120. Dudek & Smyth, *supra* note 117, at 29.

121. *Id.* at 30.

122. *Id.*; *see generally* MICH. COMP. LAWS § 570.1201 (2008)

123. Dudek & Smyth, *supra* note 117, at 30; s*ee also* Erb Lumber, Inc. v. Gidley, 594 N.W.2d 81, 85 (Mich. Ct. App. 1999) (holding that the Legislature intended to protect the homeowner from paying the lienor amounts already paid to the contractor).

124. MICH. COMP. LAWS § 570.1201 (2008); Dudek & Smyth, *supra* note 117, at 30.

125. Dudek & Smyth, *supra* note 117, at 29–31.

126. MICH. COMP. LAWS § 570.1203 (2008).

127. 594 N.W.2d 81 (Mich. Ct. App. 1999).

128. *Id.* at 86–87.

129. Dudek & Smyth, *supra* note 117, at 31.

130. MICH. COMP. LAWS § 570.1204 (2008).

131. *Construction Lien Law Changes Signed*, MICH. CONTRACTOR & BUILDER, Aug. 20, 2007 at 18, 18.

owner or lessee notify subcontractors, suppliers and laborers upon receiving a contractor's sworn statement and, upon request, give them a copy of the statement."[132] Additionally, an owner or lessee may not rely on a waiver of lien provided by someone other than the lien claimant without verifying the waiver.[133]

V. PROPOSED REVISIONS TO FLORIDA'S NON-PRIVITY CONSTRUCTION LIEN STATUTE

To better protect homeowners while also balancing the interests of subcontractors, Florida should reconsider adopting a residential construction lien statute that prevents subcontractors from placing liens on residential property after the property has reached its end-market owner,[134] or when the property owner can prove that payment intended to cover the subcontractor's costs has already been paid to the contractor.[135] While protecting homeowners who have already bought their homes or have already paid the contractor, these statutory provisions would also protect subcontractors if the homeowner has not yet paid the contractor. Other states, such as Tennessee, have adopted similar statutes with varying success.[136] For the reasons discussed below, different requirements for residential and commercial property owners and developers are necessary.

A. *Barring Non-Privity Liens on Owner-Occupied Residences*

The simplest and most sweeping solution to the homeowner-subcontractor construction lien problem is to bifurcate the construction lien statutes to exempt owner-occupied dwellings from subcontractor's construction liens in some or all situations.[137] Similar to the approach of the Tennessee statute, Florida could bar subcontractors' liens on all owner-occupied residences,[138] or at least on all residences where the homeowner has proof of payment in full to the contractor.[139] Such a statute would shift the risk of default back to the contractor and subcontractors. This broad prohibition, while allowing exceptions for non-

132. *Id.*

133. *Id.* The 2007 amendment clarified that the law only applied to residential owners, amending ambiguity in the law that suggested commercial owners may also be subject to the statute.

134. To clarify: developers, contractors, and home retailers should be liable for loans, whereas those intending to use the home as a domicile should not be subject to construction liens. Tennessee has similar statutory language only exempting property used as domicile. *See supra* Part IV.A.

135. Similar to the Michigan case law, see *supra* Section IV.B.

136. *See* TENN. CODE ANN. §§ 66-11-101, 142, 146 (2008).

137. *See, e.g.*, Op-Ed., *Protecting the Home Buyers*, SARASOTA HERALD-TRIB., June 9, 1996 at 2F.

138. *Id.*

139. *Id.*

privity liens in limited circumstances, would be adequate to protect both subcontractors and homeowners and would provide a right of action to sue the contractor without disrupting the general rule that one must be in privity with the other party to receive any legal benefits from breach of contract.[140] In most cases, subcontractors would be forced to go after contractors for payment, rather than involve the homeowner who has paid in good faith.[141] Even when subcontractors cannot place construction liens on homes, the subcontractor would not be barred from suing the homeowner for unjust enrichment when the homeowner has not substantially paid the general contractor.[142]

B. *Eliminating Attorneys' Fees and Costs from Residential Non-Privity Liens*

Many non-privity liens filed on owner-occupied residences are for sums of money that would not justify the expense of hiring an attorney.[143] This observation is especially influential given Florida's award of attorneys' fees and costs, and risk of treble damages in construction lien cases.[144] While the penalty of attorneys' fees and costs may be justified to prevent unnecessary litigation over liens in the commercial sector, it is too

140. *See* Spolski Gen. Contractor, Inc. v. Jett-Aire Corp. Aviation Mgmt. of Cent. Fla., Inc., 637 So. 2d 968, 970 (Fla. 5th DCA 1994) ("Judgment on the pleadings and final summary judgment were properly granted . . . because there was no sale from Moore to Spolski, no privity between Spolski and Moore, no contract between Spolski and Moore . . . [and] no relationship between Spolski and Moore on the Jett-Aire project."); Affiliates for Evaluation & Therapy, Inc. v. Viasyn Corp., 500 So. 2d 688, 693 (Fla. 3d DCA 1987); *see also* Patricia Duffy, Note, *The Economic Loss Rule and Florida's Exception for General Contractors*, 46 FLA. L. REV. 775, 797–99 (1994). *But see* Power Ski of Fla., Inc. v. Allied Chem. Corp., 188 So. 2d 13, 14 (Fla. 3d DCA 1966) ("[D]irect privity . . . is no longer a necessary prerequisite to a breach of implied warranty case.") (citations omitted).

141. *See* Op-Ed., *supra* note 137.

142. *See* Jennings, *supra* note 91, at 272. Numerous states allow quantum meruit recovery for subcontractors in cases where denying quantum meruit would result in unjust enrichment of the homeowner, while declining to extend quantum meruit in cases where the subcontractor was not paid due to the contractor's mismanagement of funds. *Id.* New Mexico and Ohio are only two of many states that recognize a cause of action under the aforementioned circumstances. Ontiveros Insulation Co. v. Sanchez, 3 P.3d 695, 700 (N.M. Ct. App. 2000); Booher Carpet Sales, Inc. v. Erickson, No. 98-CA-0007, 1998 WL 677159, at *7 (Ohio Ct. App. Oct. 2, 1998) (finding unjust enrichment claims by the subcontractor are meritorious where "the owner enjoys, at the subcontractor's expense, an unfair windfall from whatever caused the general contractor to accept less than the agreed amount and breach its obligation to the subcontractor").

143. "Discourage litigation. . . . Point out to [your neighbors] that a nominal winner is often a real loser—in fees, expenses, and a waste of time." Abraham Lincoln, Notes for a Law Lecture, (July 1, 1850). This statement could hardly be more true than in litigation over construction liens, where even the "winner" has spent numerous hours and much stress fretting over the dilemma.

144. *See* Dudley, *supra* note 37, at 35 (stating that homeowners should consider carefully with their attorneys and be aware of the possibility of an award of attorneys' fees and costs against them before undertaking dispute of a subcontractor's construction lien).

harsh for homeowners.[145] First, for homeowners, the fear of paying attorneys' fees in addition to the construction lien may deter homeowners from disputing fraudulent liens—instead homeowners may settle to avoid the nuisance and costs of an adverse verdict.[146] Second, awards for costs and fees are not as persuasive when homeowners may only deal with construction liens once or twice in a lifetime.[147] Third, homeowners whose contractor has gone out of business may not have enough information at the outset of the case to determine whether the lien is meritorious or not, and these homeowners should not be discouraged from discovering the circumstances of the lien by the concern of paying the other side's attorneys' fees.[148]

On the other hand, removal of attorney's fees awards may also penalize some homeowners who successfully defend a fraudulent lien or even create a disincentive that prevents lawyers from taking the cases.[149] However, the removal may also prevent attorneys from needlessly litigating to verdict in hopes of recovering fees as part of the judgment, thereby reducing the burdens on the state courts.[150] Eliminating attorneys' fees and costs as well as treble damages may incentivize homeowners to

145. In the case of construction liens for small amounts of money or where the homeowner faces multiple liens, no single lien may be costly enough to justify hiring an attorney.

146. Florida's median family income is $57,523, and the median home price in Florida is nearly 4.5 times the median income. Freddie Mac, Making Home Possible in Florida, at 3, *available at* http://www.freddiemac.com/corporate/about/pdf/Florida.pdf (last visited Nov. 14, 2008). Even among homeowners, money is often tight after a recent home purchase, and those faced with a lien may pay the lien rather than face risk of losing their home entirely if they lose the suit and face a judgment for attorneys' fees and costs.

147. The fees fail to deter unnecessary litigation of construction liens because most homeowners will never have a second opportunity to dispute a construction lien.

148. Homeowner-plaintiffs may be forced to wait until the discovery phase of a suit to obtain access to the contractor's records, particularly if the contractor is not brought in as a necessary party in the lawsuit. Thus, at the outset homeowners may not know the strength of their case and whether the contractor (1) already paid the subcontractor or (2) had a legitimate reason to withhold the fund (such as breach of contract).

149. "[P]rivate enforcement of statutes is unlikely if aggrieved citizens lack financial resources to pay lawyers for their services. Fee awards are an integral part of the remedies available to ensure compliance with various Congressional statutes." Standard Guar. Ins. Co. v. Quanstrom, 555 So. 2d 828, 832 (Fla.1990). While this case addresses congressional statute enforcement and award of attorneys' fees, an analogy can be drawn for providing incentive for attorneys to take on residential homeowner cases and defending against fraudulent construction liens.

150. "If attorneys' fees were assessable in all cases without regard to whether or not a lawsuit was filed, then the stated intent or purpose of the statute—to prevent litigation—might well be defeated. An insurance company would have no incentive to settle a claim quickly and out of court if it faced an award of attorney's fees in any case. We thus conclude that attorney's fees under section 627.428 cannot be awarded where no suit is filed prior to payment of the full amount of the proceeds due under the insurance policy." Florida Life Ins. Co. v. Fickes, 613 So. 2d 501, 504 (Fla. 5th DCA 1993). While the court here discussed an insurance company's incentive to settle, similar incentives exist for contractors and subcontractors in suits against homeowners.

defend potentially meritorious claims. However, Florida's non-privity construction lien statutory scheme could be better served by removing most homeowners from the statute altogether and instead only allowing an award of fees and costs when homeowners not covered by the exemption insist on fighting valid liens.

C. *Requiring Payment Bonds for Residential Property*

If the law changed to protect homeowners by requiring payment bonds, subcontractors could simply require payment bonds assuring payment from contractors prior to beginning work.[151] The payment bonds demanded by subcontractors would incentivize solvency among contractors.[152] The reduction of insolvent contractors competing for business would potentially reduce the number of contractors and thus increase cost to the homeowner, but this solution would sufficiently "spread the risk" from individual homeowners to the industry as a whole.

While payment bonds are recognized in the construction-law chapter of Florida statutes as an acceptable way to ensure payment of subcontractors and protect the buyer,[153] bonds have not been popular in residential real estate projects to the same degree as public construction projects because bonds often cost a significant amount of money to insure the project.[154] For example, it might cost a homeowner $500 to obtain a bond for a $10,000 construction project.[155] To many homeowners, this markup of five percent[156] is not worth the expense because it may limit the amount of house they can afford.[157] Further, few homeowners are aware of payment bonds as insurance for their construction projects,[158] so

151. Black's Law Dictionary defines "payment bond" as "[a] bond given by a surety to cover any amounts that, because of the general contractor's default, are not paid to a subcontractor or materialman." BLACK'S LAW DICTIONARY 189 (8th ed. 2004). Payment bonds, while rarely used in the residential context today, are commonplace as a form of insurance for subcontractors and general contractors in commercial projects. *See* Lawson, *supra* note 44, at 61–62. If Florida's construction liens apply to residential owners, bonds should be used to protect the property owner similar to in commercial projects. However, consumers probably fail to demand payment bonds because they are generally naïve about construction law. This is yet a further reason why the construction lien law for subcontractors should not apply to residential property owners. For further discussion regarding the recovery of payment bonds, see John H. Rains IV, Comment, *Construction Law*: *Enforcing the Notice and Filing Requirements of "Florida's Little Miller Act"—An Adventure in Statutory Construction*, 58 FLA. L. REV. 425, 426–29 (2006).

152. *Post Bond on a Home? It's Rare*, S. FLA. SUN-SENTINEL, July 3, 1998, at 3E.

153. FLA. STAT. § 713.23 (2008); *see also* Rains, *supra* note 151, at 427.

154. *See Post Bond on a Home? It's Rare*, *supra* note 152.

155. *Id.*

156. *See supra* text accompanying note 15, noting that many homeowners only have five percent to use as a down payment on a home purchase (making it unrealistic that the same homeowners could pay an additional five percent in payment bonds).

157. *See Post Bond on a Home? It's Rare*, *supra* note 152.

158. Particularly among those buying homes without the advice of a real estate attorney, few

changing the law to require bonds could require significant efforts to educate consumers.

D. *Piercing the Contractor's Corporate Veil*

The Florida Legislature has created civil and criminal penalties for contractors and subcontractors who intentionally participate in fraudulent liens.[159] The current statute allows for recovery from the Florida Homeowners Recovery Fund if the members of the Construction Fund Board adjudicate a contractor or subcontractor to have mismanaged funds.[160] However, corporations have limited liability for failure of the homes they build or leave unfinished. Criminal penalties require intentional or fraudulent conduct, but Florida law could be revised to deter mismanagement—and shift the risk back to the contractor—by allowing piercing of the contractor's corporate veil when it is proven that the contractor mismanaged funds.[161] The Florida Supreme Court explained in *Continental Distilling Sales* that:

> Corporations are legal entities by fiction of law. Their purpose is generally to limit liability and serve a business convenience. Courts are reluctant to pierce the corporate veil and only in exceptional cases will they do so. Such instances are for fraud as where creditors are misled and defrauded or where the corporation is created for some illegal purpose or to commit an illegal act.[162]

While the corporate veil doctrine rarely succeeds to hold an owner liable for the acts of his corporation, the doctrine might succeed in the most egregious cases of contractor mismanagement, particularly in cases where the contractor would also be liable for criminal conduct, such as filing a fraudulent lien or misappropriation of funds.[163]

While the threat of piercing the corporate veil may deter some contractors from bidding on projects, demand for more reputable

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sources suggest payment bonds be used for residential real estate. If bonds were suddenly required for residential real estate construction, it could lead to a shortage in underwriting for this type of insurance, and lack of availability of bond companies willing to bond "small potatoes" jobs, leaving homeowners in no better position than prior to amending the statutes to require payment bonds.

159. *See* FLA. STAT. § 713.31 (2008); LEIBY, *supra* note 22, § 8.68 (noting that the crime may be a "felony of the third degree"). The Homeowners Recovery Fund may cover a criminal or civil judgment against a contractor, but such a result requires the homeowner to take the case to judgment with no guarantees of recovering from the fund. *See supra* notes 100–04 and accompanying text.

160. *See supra* notes 100–04 and accompanying text.

161. *Id.*; *see also supra* notes 93–97 and accompanying text (prosecuting a general contractor for misappropriation of funds, a felony, by the state attorney).

162. State *ex rel.* Cont'l Distilling Sales Co. v. Vocelle, 27 So. 2d 728, 729 (Fla. 1946).

163. *See* § 713.31.

contractors should increase if weaker contractors close because of threats to their personal finances.[164] While the Florida Legislature could revise the construction lien statute to allow for personal liability for mismanaged funds, such a statute would likely be unworkable. Moreover, contractors have effective lobbyists in Tallahassee—as evidenced by their lobbying efforts to enact the current lien law[165]—and Florida courts have demonstrated their reluctance to pierce the corporate veil, absent clear and convincing proof of improper conduct or "an intent to mislead or defraud creditors."[166] Additionally, contractors who have mismanaged funds are unlikely to have significant personal assets sufficient to cover any suits brought against them.[167] Finally, bringing a suit to pierce the contractor's corporate veil would be costly and time-consuming for homeowners. In much the same way that fighting a construction lien poses a threat, suing to pierce the corporate veil may not make economic sense when attorneys' fees and costs are at risk.[168]

E. *A Modest Proposal*

Florida should adopt a policy protecting homeowners and should revamp its homeowners' recovery fund to protect subcontractors as does Michigan, which protects homeowners from double payment for construction jobs.[169] While Tennessee's statute better protects homeowners by shielding them from liability for construction liens, the Michigan statute better balances the interests of homeowners and subcontractors. Michigan only protects homeowners who have paid the amount for the subcontractor's labor to the general contractor and allows subcontractors

164. In fact, finding a reputable general contractor seems to be the most common piece of advice given to residential property owners beginning a project. *See* James, *supra* note 16. *But see* Maggie Galehouse, *Builder's Woes Send Couple's Dream Home Down Toilet*, SARASOTA HERALD-TRIB., Jan. 2, 2001, at A1 (noting that buyers may be subject to subcontractors' liens even when they bank on the reputation of a construction company, particularly in cases where the general contractor's construction company has been sold).

165. *See, e.g.*, Dudley, Buzzett & Kearney, *supra* note 21, at 258.

166. Hobco, Inc. v. Tallahassee Assocs., 807 F.2d 1529, 1534 (11th Cir. 1987) (citing Dania Jai-Alai Palace, Inc. v. Sykes, 450 So. 2d 1114, 1120 (Fla. 1984)).

167. One of the most significant risk factors for misappropriation of funds in the more general area of white-collar crime is significant personal debts. Rocco R. Vanasco, *Fraud Accounting*, 13 MANAGERIAL AUDITING J. 4, 64 (1998). Increased personal debt make it less likely that a homeowner who obtains a judgment against the contractor will successfully execute the judgment. For anecdotal evidence indicating that individual contractors often file for bankruptcy protection when filing for their companies, see *supra* notes 93–97 and accompanying text.

168. Attorneys' fees may already be the greatest economic consideration in whether to dispute a subcontractor's lien. When the additional cost of suing the contractor in his individual capacity is considered, this solution would seem to make sense only where the contractor might be liable for punitive damages (such as for intentional torts) or where an appeal to an "insurance" system, such as the current homeowners recovery fund, denied payment of the claim.

169. *See supra* Part IV for a detailed description of the Tennessee and Michigan construction lien statutes.

to post liens only to the extent of the entire general contract amount.[170]

Tennessee's statute is too broad to apply in Florida because a statute such as Tennessee's would shield homeowners from liens on their homes even where the homeowner is undoubtedly liable for payment.[171] Essentially, Florida should not allow the home to be used as a shield to avoid paying for improvements (a scenario that could hurt the construction industry) and should only protect those who have already paid the contractor for a portion of the job.[172]

Michigan's statute accurately balances the risks of the homeowner and subcontractor by providing homeowners an affirmative defense when they can prove they have paid the contractor for the portion of the job upon which the subcontractor wishes to place a lien, while providing subcontractors with a fund to pay them when the contractor fails to do so.[173] Contractors receiving construction licenses are required to fund the payments through a fee required with their application,[174] meaning that contractors essentially insure subcontractors for the risk that they will be unpaid. In sum, such a statute would apportion the risk of contractor insolvency, while preventing the contractor, subcontractor, or homeowner from taking advantage of the other parties to the construction.

VI. CONCLUSION

Florida's current construction lien law simply fails to adequately protect homeowners from predatory contractors and contractors that mismanage their funds.[175] As numerous attempts at reforming the residential construction lien law demonstrate, homeowners completing after-market improvements should be exempt from the risks that contractors will fail to pay materials suppliers and laborers. Homeowners enjoy significant protection in other areas of property law, including homestead exemptions, and similarly, should receive broad protection for payments made for home improvement.[176]

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170. MICH. COMP. LAWS § 570.1203 (2008).

171. *See* TENN. CODE ANN. § 66-11-146(a)(2) (2008) for statutory language exempting all domiciled single family homes or duplexes. Note that Tennessee does not protect co-ops or condominiums by its express language, which are prevalent forms of housing in Florida.

172. Further research would be needed to determine whether expanding the homestead exemption to bar construction lien foreclosure would be feasible.

173. This is well-apportioned because the contractors insure the subcontractors for payment without requiring an expensive payment bond. While the recovery fund fee is a transaction cost, the fee is low enough that is should not disincentivize many contractors from entering the industry.

174. The current fee is $50, but an additional fee is imposed if the fund dips below a specified balance. *See supra* Part IV.B.

175. Though this is the explicit purpose of the Homeowners Recovery Fund.

176. For example, debtors are protected by the Consumer Credit Protection Act to a maximum garnishment of the lesser of twenty-five percent of wages or thirty times the federal minimum wage. 15 U.S.C. § 1673 (2006); *see* Hynes, *supra* note 83, at 12–13. Essentially, Congress was concerned that debtors wouldn't be able to provide for their basic needs (including shelter) if too high a percentage of wages are garnished to satisfy antecedent debts. 15 U.S.C. § 1671 (2006)

The construction lien law should be revised to rebalance the risks apportioned to homeowners and subcontractors in case of a contractor's default of payments to subcontractors and materials suppliers. To accomplish this goal, new provisions of the construction lien law should be drafted to apply to homeowners, using qualifying language similar to that of the Florida homestead exemption.[177] Homeowners typically complete few "large-ticket" projects, have little opportunity to spread the risk, and lack an incentive to object to fraudulent liens because attorneys' fees will often devour more than the amount due on the lien itself.[178] Until the law is changed, homeowners should hire a construction lawyer long before notices of construction liens begin piling up.[179]

Florida is one of a minority of states willing to shift risk of the construction industry's failure entirely to the homeowner. Most states exempt residential improvements from construction lien laws altogether, and those states that allow construction liens on residential property do so in very limited situations to prevent injustice or a windfall to the homeowner at the expense of the subcontractor.[180] Florida should adopt a residential statute similar to that of Michigan, which protects homeowners from "double payment" and gives the homeowner an absolute defense to subcontractors' construction liens that exceed the total contract price.[181]

("The application of garnishment as a creditors' remedy frequently results in loss of employment by the debtor, and the resulting disruption of employment, production, and consumption constitutes a substantial burden on interstate commerce."). By approving of non-privity construction liens for residential homeowners, however, the Florida Legislature has not provided analogous safeguards for homeowners trying to provide one of the most basic needs: housing. The public policy concern justifying a wage garnishment cap should furnish similar safeguards for homeowners at risk of losing their homes by foreclosure of a subcontractor's construction lien. Unlike the debtor whose wages are garnished, homeowners may have already legitimately paid the amount due to the subcontractor, yet the homeowner is subjected to loss of the home even where the "debtor" may not have agreed to pay the debt in the first place. *See supra* note 12 and accompanying text.

177. These improvements would include, at a minimum, providing protection where homeowners have proof of full payment to the contractor. Such a law would only bring Florida to a minimal standard in comparison with other states.

178. *See supra* note 147 and accompanying text regarding homeowners' potential to make only one or two major purchases and have only one or two dealings with general contractors during their lifetime.

179. *See* Jack Snyder, *Beware the Mean Lien Machine; Olympia Homes Shows What Can Go Wrong*, ORLANDO SENTINEL, Jan. 11, 1998, at H1.

180. *See* Jennings, *supra* note 91, at 272.

181. *See* MICH. COMP. LAWS § 570.1203 (2008).