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THE HARDEMAN ACT—SOME UNANSWERED QUESTIONS

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INTRODUCTION

Controversy has been generated by recent cases concerned with the relative priorities of deeds of trust given to secure construction loans and the liens of mechanics and materialmen. Some of the decisions have turned on whether the statute which purports to regulate priorities contemplates a single lien in which all mechanics and materialmen share, a separate lien for each individual claimant, or a series of liens for each claimant. A related question has been whether the statute requiring retainage of funds by an owner for the benefit of unknown claimants creates in all cases a single fund in which all such claimants share equally, or whether it creates several separate funds when there is no general contract, each of which is available to a limited group of claimants. The statutory priority of a mechanic's and materialman's lien over earlier liens on the real estate also continues to present questions of interest to all segments of the construction industry. These are the principal topics to be explored in this article.

INCEPTION OF THE LIEN

Custom, if not logic, demands that any discussion of priority of mechanics' and materialmen's liens begin with *Oriental Hotel Co. v. Griffiths*.¹ The significance of the case lies in the fact that it was the first to be decided after the statute which regulates the priority between mechanics' liens and other liens on the same property was amended into its present form. The statute, article 5459,² is less than

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1. 88 Tex. 574, 33 S.W. 652 (1895).

2. TEX. REV. CIV. STAT. ANN. art. 5459 (1958), as amended, TEX. REV. CIV. STAT. ANN. art. 5459 (Supp. 1974).

satisfactory from the standpoint of clarity, but it has been interpreted to mean that a mechanic's and materialman's lien has priority, as to both land and improvements, over all liens except those which were in existence at the time of the inception of the mechanic's lien.³ The *Oriental Hotel* case has been a source of difficulty and confusion because of conflicting statements in the opinion as to the nature of the fact situation that was before the court. The courts in later decisions have vacillated in their interpretations, but the version that seems to be accepted currently by the supreme court can be illustrated by the following hypothetical case: Owner of a lot completes and pays for the foundation of a building. He then enters into a contract with K to furnish all labor and materials for the completion of the building, with the exception of heating equipment and elevators, which the owner is to arrange to have installed by other persons. K begins work, and a short time thereafter, Owner obtains a construction loan from Bank, secured by a deed of trust which is promptly recorded. After the recording of the deed of trust, H enters into a contract with Owner for the heating equipment, and E contracts with Owner for installation of elevators. Both H and E furnish the labor and materials required by their respective contracts. All of these original contractors, K, H, and E, perfect their liens by filing.

Assuming the facts to have been as stated above, the *Oriental Hotel* case holds that not only K, but also H and E have priority over the Bank, notwithstanding that H and E entered into no contracts with the owner, nor did they furnish and labor and materials, until after the deed of trust was recorded.⁴ This means, of course, that the claims of all of the original contractors relate back to the date when the lien of the first of them (K in our hypothetical case) had its inception.⁵ The reasoning in *Oriental Hotel* is based on what is now article 5468, which provides that "the liens as perfected under this Act shall be upon an equal footing without reference to date of filing the

3. *University Sav. & Loan Ass'n v. Security Lumber Co.*, 423 S.W.2d 287, 293 (Tex. Sup. 1967). Prior to an amendment in 1889, the statute had fixed the critical date as that on which the lien accrued, rather than the time of its inception. See 9 H. GAMMEL, LAWS OF TEXAS 1138 (1898); *University Sav. & Loan Ass'n v. Security Lumber Co.*, 423 S.W.2d 287, 294 (Tex. Sup. 1967). The statute also provides for priority of the mechanics' and materialmen's lien over preexisting liens on the real estate, insofar as the improvement is concerned, in some instances.

4. *Oriental Hotel Co. v. Griffiths*, 88 Tex. 574, 584-85, 33 S.W. 652, 662 (1895).

5. See Helm, *Establishment and Priority of Liens for the Development and Improvement of Real Estate*, 20 BAYLOR L. REV. 387 (1968).

account or affidavit claiming the lien." The statute continues that if the proceeds from foreclosure are insufficient to satisfy all mechanics' and materialmen's liens, they shall be paid pro rata to the various claimants. How, asked the court, could the liens of the heating and elevator contractors, H and E, have equality with those of K, unless all have their inception on the same date?⁶

It appeared for a time that *Oriental Hotel* might have been overruled by cases which construed its fact situation as one in which there was only a single, general contract executed by the owner, so that all of the claimants involved, other than the general contractor, were subcontractors.⁷ In *McConnell v. Mortgage Investment Co.*,⁸ it was said:

That the holding in the *Oriental Hotel* Company case is bottomed squarely upon the circumstance that the building has been projected and a contract for its construction executed by the owner and a contractor is made clear by Judge Brown's later opinion in the *Texas Briquette* case.⁹

Judge Brown did indeed seem to take this view and he was the one who had written the opinion in the *Oriental Hotel* case. In discussing *Oriental Hotel* in *Sullivan & Co. v. Texas Briquette & Coal Co.*,¹⁰ he had said:

In that case Griffiths had entered into a contract with the *Oriental Hotel* Company for the construction, upon the lot which it then owned, of a building according to specifications then furnished and embracing *all work* which was subsequently done or *for which material was furnished* by the persons who claimed liens in that case.¹¹

In *University Savings & Loan Association v. Security Lumber*

6. In later cases it has been recognized that article 5468, the "equality of lien statute," cannot be given effect in some instances without bringing it into irreconcilable conflict with other statutes. See, e.g., *Rotsky v. Kelsey Lumber Co.*, 228 S.W. 558 (Tex. Comm'n App. 1921, jdgmt adopted); *First Nat. Bank v. Lyon-Gray Lumber Co.*, 110 Tex. 162, 217 S.W. 133 (1919).

7. *D. Sullivan & Co. v. Texas Briquette & Coal Co.*, 94 Tex. 541, 545-46, 63 S.W. 307, 308 (1901). See also *Pierce v. Mays*, 277 S.W.2d 155 (Tex. Civ. App.—Amarillo 1954), *aff'd*, 154 Tex. 489, 281 S.W.2d 79 (1955); *Crabb v. William Cameron Lumber Co.*, 63 S.W.2d 367 (Tex. Comm'n App. 1933, jdgmt adopted); *Quinn v. Dickinson*, 146 S.W. 993 (Tex. Civ. App.—Amarillo 1912, no writ); Helm, *Establishment and Priority of Liens for the Development and Improvement of Real Estate*, 20 BAYLOR L. REV. 387 (1968).

8. 157 Tex. 572, 305 S.W.2d 280 (1957).

9. *Id.* at 579-80, 305 S.W.2d at 284.

10. 94 Tex. 541, 63 S.W. 307 (1901).

11. *Id.* at 546, 63 S.W. at 308 (emphasis added); see Olds, *Priorities in the Texas Law of Mechanic's Liens*, 2 HOUS. L. REV. 328, 333 (1965).

Co.,¹² however, the court summarized the facts in *Oriental Hotel* as being substantially the same as those stated in the hypothetical case, making it clear that there were several original contracts with the owner, rather than one general contract for all labor and materials.¹³ The most recent interpretation of the *Oriental Hotel* case by the supreme court is in the first opinion in *Irving Lumber Co. v. Alltex Mortgage Co.*¹⁴ in which the facts and holding of *Oriental Hotel* were summarized as follows:

[O]n February 24, 1890, the owner entered into a contract with John Griffiths to complete a hotel building on the foundation. [Previously completed by the owner and presumably paid for.] On May 1, 1890, the hotel company executed a deed of trust to St. Louis Trust Company to secure the hotel company's bonds issued and sold in order to finance hotel construction. After recordation of the deed of trust, other contracts (for heating and elevators) were let and the work performed. After the hotel was completed, Griffiths and the others who had furnished labor and materials under contracts executed subsequent to the recordation of the deed of trust sought to foreclose their mechanic's and materialmen's liens. We held that all of the mechanic's and materialmen's liens were entitled to priority over the deed of trust lien, despite the fact that Griffiths did not have a general contract for the construction of the whole improvement.¹⁵

This opinion was withdrawn, but without any suggestion that the language quoted did not continue to be the thinking of the majority of the court. The question, then, is whether the *Oriental Hotel* doctrine, as pronounced in the above quote, has been altered by the recent amendment to article 5459. But before attempting an answer, it is necessary to consider the background of that amendment.

A related and somewhat less complicated problem, which can again be illustrated hypothetically, provides a beginning point. Assume a situation in which O, the owner of a lot, buys an order of materials from M and has them delivered to the jobsite. He thereafter obtains a construction loan from Bank and its deed of trust is recorded. O

12. 423 S.W.2d 287 (Tex. Sup. 1967).

13. *Id.* at 294-95. This conclusion is the only reasonable one, as the court in *Oriental Hotel* accorded an equal degree of priority to K, H, and E, decreeing that they were to share equally in the foreclosure proceeds on a pro rata basis. This would have been patently erroneous had H and E been subcontractors to whom K was indebted.

14. 14 Tex. Sup. Ct. J. 212 (Feb. 6, 1971) [this opinion was subsequently withdrawn, the substitute opinion appearing at 468 S.W.2d 341 (Tex. Sup. 1971)].

15. *Irving Lumber Co. v. Alltex Mortgage Co.*, 14 Tex. Sup. Ct. J. 213 (Feb. 6, 1971).

has no contract under which M is to furnish additional materials, but he makes additional orders, all of which are delivered subsequent to the recording of the deed of trust. O is insolvent, and there is a contest between M and Bank for priority. In this situation the supreme court recently held, in *University Savings & Loan Association v. Security Lumber Co.*,¹⁶ that M has priority over Bank, not only for materials delivered prior to the recording of the deed of trust, but also for those delivered subsequent to that date.¹⁷ The court reasoned that the statute contemplated a single lien and not a series of liens;¹⁸ thus M, the materialman, must be given priority for all of the materials delivered to the job, or else subordinated to the deed of trust for his entire claim. The *Oriental Hotel* case was then looked to as the principal authority for the proposition that the materialman's lien should be accorded complete priority over the deed of trust lien.¹⁹

There was only one materialman's lien claimant in *Security Lumber Co.*, all others apparently having been paid out of the proceeds of the construction loan. *Security Lumber Co.* established the proposition that the individual "liens of laborers and materialmen, when perfected, will relate back to the date of their 'inception'" and that the inception does not depend upon the existence of a contract, whether written or oral, general or otherwise.²⁰ Previously, there had been no occasion to doubt that a properly recorded contract could give rise to the inception of a lien²¹ or that an unrecorded contract, together with visible work on the premises, could give rise to its inception.²² The novelty of *Security Lumber Co.* was its holding that the lien could have its inception in the mere delivery of materials, even in the absence of a contract.²³ It remained uncertain, however, whether a lien could have its inception, as against a subsequent purchaser or mortgagee, in an oral contract or an unrecorded written contract, when the existence of the incipient lien could not be discovered from an inspection of the land.

16. 423 S.W.2d 287 (Tex. Sup. 1967).

17. *Id.* at 296.

18. *Id.* at 296.

19. *Id.* at 295.

20. *Id.* at 295, 296.

21. Recording is authorized by TEX. REV. CIV. STAT. ANN. art. 5453 (Supp. 1974) as well as TEX. REV. CIV. STAT. ANN. art. 6626 (1969).

22. *Oriental Hotel Co. v. Griffiths*, 88 Tex. 574, 581-82, 33 S.W. 652, 661 (1895).

23. *University Sav. & Loan Ass'n v. Security Lumber Co.*, 423 S.W.2d 287, 296 (Tex. Sup. 1967).

In *Irving Lumber Co. v. Alltex Mortgage Co.*,²⁴ it was alleged by the lumber company that it made an oral contract with Merit Homes, Inc. to furnish labor and materials for building four houses through the shell state of construction. The lower courts failed to make a determination as to whether such an oral contract actually existed, but for the purpose of its opinion, the supreme court assumed that it did.²⁵ When the oral contract was made, *Merit Homes did not even own three of the lots*, and the fourth was encumbered by a vendor's lien. A few days after the making of the oral contract, Merit Homes executed a note to Alltex in the amount of \$137,850, secured by a deed of trust on the four lots (and other properties not involved in the controversy). At the time Alltex took its deed of trust, no labor or materials had been furnished by the lumber company, nothing was on record showing its claim of an oral contract, and Alltex had no actual knowledge of the alleged oral contract.

After the deed of trust was recorded, the lumber company commenced and completed performance of the oral contract and filed an affidavit claiming a lien within the time required by statute. Merit Homes had agreed to pay for the work upon completion, but was at that time insolvent. There is no statement in the opinions of either the supreme court or the court of civil appeals as to whether Merit Homes had wrongfully diverted the money from the construction loan to other purposes, or whether it was simply underfinanced. The question then arose as to whether the deed of trust lien was superior to the lien of the lumber company. It was conceded that Alltex had priority as to the vendor's lien to which it was subrogated, as to one of the lots, and as to the portion of the Alltex loan used as purchase money for the others.

Alltex contended that the rule of the *Oriental Hotel* case was inapplicable because the alleged contract was not a "general contract," *i.e.*, that it did not encompass all of the work necessary for the completion of the houses. As previously noted, this contention was rejected because the court construed the *Oriental Hotel* case as one in which there was no general contract, but rather several separate contracts. It was reasoned that because of the use of the words "inception

24. 468 S.W.2d 341 (Tex. Sup. 1971). The opinion of the court of civil appeals is noted in 1 ST. MARY'S L.J. 280 (1969).

25. *Irving Lumber Co. v. Alltex Mortgage Co.*, 14 Tex. Sup. Ct. J. 212, 215 (Feb. 6, 1971) [opinion subsequently withdrawn]. The case was to have been remanded to the trial court for a finding of fact on that issue.

of the lien" in article 5459, the lien related back to the date of the oral contract.²⁶

This opinion was withdrawn on rehearing for the reason that Merit Homes was not the owner of the lots at the time the oral contract was made.²⁷ It was held that the lien could not have its inception in a contract between a contractor and a mere prospective owner.²⁸ The actual holding of the withdrawn opinion, necessarily limited to the facts before the court, was that when there is an oral contract for a portion of the work, the lien of the contractor has its inception on the date of the contract, and takes priority over a subsequently executed deed of trust.²⁹

The decisions in the *Security Lumber* and *Alltex* cases placed the lender in a precarious position. The former held that any delivery of materials prior to the recording of a deed of trust would give to that particular materialman complete priority as to all materials thereafter delivered. The *Oriental Hotel* doctrine, as construed in these decisions, would extend the priority to all of those who might thereafter furnish labor and materials, even though the claimants had no relationship with the first contractor. Finally, under *Alltex*, the date of an oral contract made before the execution and recording of a deed of trust would serve as the inception date for the lien of the person claiming under it, and presumably would also give priority to all of those who might later furnish labor and material. The result was that few lenders were willing to continue to make construction loans when their money could be invested in less hazardous enterprises.³⁰

The *Alltex* holding that the lien related back to the date of the oral contract was one critical to lending institutions, as no amount of dili-

26. *Id.* at 213.

27. *Irving Lumber Co. v. Alltex Mortgage Co.*, 468 S.W.2d 341, 343 (Tex. Sup. 1971). No attention is given in the opinion to the fact that Merit Homes apparently did have title to one of the four lots under a deed in which the grantor had reserved a vendor's lien.

28. *Id.* at 343. The possible effect of the amendment of article 5459 on this holding is discussed in Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 694-95 (1972).

29. *Irving Lumber Co. v. Alltex Mortgage Co.*, 14 Tex. Cup. Ct. J. 212, 214-15 (Feb. 6, 1971).

30. The ability of the lender to protect himself by putting supervisory personnel on the jobsite to "police" the disbursement of loan funds, at the expense of the borrower, was restricted by the holding, in *Terry v. Teachworth*, 431 S.W.2d 918 (Tex. Civ. App.—Houston [14th Dist.] 1968, writ ref'd n.r.e.), that the charges for this service were additional interest, which would in many instances make the loan transaction usurious.

gence and care could insure the lender that it was getting a first lien on the property. Shortly after the first, and subsequently withdrawn, opinion in *Alltex* was delivered, article 5459 was amended.³¹ The legislative action was undoubtedly directed mainly, and possibly solely, toward reducing the hazards arising out of the holding that a lien might have its inception, for priority purposes, on the date of the making of an oral contract. The language of the old statute was retained unchanged in section 1 of the amended statute. The new material appeared as section 2, which provides that the inception of "the lien, as used in this article," should be upon the date when one of the three events set out in the statute should first occur.³² These may be briefly summarized as: (1) the actual commencement of construction, or the delivery of materials to the jobsite, provided such construction or delivery is visible from an inspection of the land; (2) the recording of a written contract in the mechanic's lien records; or (3) the recording of an affidavit setting out the existence of an oral contract.³³

The amendment vastly improves the position of the lender by making it possible for him to discover the existence of liens that might

31. Section 2 of the amended statute reads as follows:

The time of the inception of the lien, as used in this article, shall mean the occurrence of the earliest of any one of the following events:

(a) The actual commencement of construction of the improvements or the delivery of material to the land upon which the improvements are to be located for use thereon for which the lien herein provided results, provided such commencement or material is actually visible from inspection of the land upon which the improvements are being made; or

(b) If the agreement for the construction of the improvements or any part thereof or the agreement to perform labor or furnish material or provide specially fabricated material in connection with such construction resulting in the lien herein provided for is written, the recording of such agreement in the Mechanic's Lien Records of the county in which said land is located; or

(c) If the agreement for the construction of the improvements or any part thereof or the agreement to perform labor or furnish material or provide specially fabricated material in connection with such construction resulting in the lien herein provided for is oral, the recording of an affidavit in the Mechanic's Lien Records of the county in which said land is located stating that the lien claimant has entered into an agreement with the owner of such property or with the owner's contractor or subcontractor for construction of improvements thereon, which affidavit shall contain a description of the land, the name and address of the lien claimant, the name and address of the person with whom the lien claimant has contracted for such improvements, labor, materials, or specially fabricated materials, and a general description of the improvements contracted for.

TEX. REV. CIV. STAT. ANN. art. 5459, § 2 (Supp. 1974).

32. An apparent error in the language of the amendment and possible difficulties in compliance are discussed in Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 694, (1972).

33. Discussions of the amended statute are found in: Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 S.W. L.J. 665, 693-94 (1972); Note, 9 HOUS. L. REV. 174, 177 (1971); Note, 50 TEXAS L. REV. 398, 401 (1971).

have a preferred status. As a result, the secret oral contract can no longer furnish the basis for the inception of a mechanic's and materialman's lien for priority purposes.

The amendment does not resolve all questions, however, with respect to the *Oriental Hotel* doctrine. Assuming that the law has been that when several different individuals enter into separate original contracts with the owner, all of their liens have their inceptions on the date when the first of such contracts is recorded, or when the first of such contractors begins work or delivers materials, has any change been made by the amendment of article 5459? It is believed that an affirmative answer should be given by the courts.³⁴

The purpose of the amendment, as declared in the emergency clause, was to alleviate "problems and confusion" arising from the first opinion in *Alltex*.³⁵ Obviously, the first and major problem was that a lender had no means by which he could be certain that he would not be subordinated to a lien arising out of an oral contract or an unrecorded written contract. However, dictum in that portion of the *Alltex* opinion discussing the *Oriental Hotel* case, to the effect that the liens of all original contractors have a common inception date, is also the source of major practical problems and the statute may have been designed for their solution.

In a situation in which there is no general contractor, suppose the owner employs someone to do the excavation work for a building, and thereafter the owner attempts to obtain a loan for completion of the project. Assuming that the excavation is the commencement of actual construction, the liens of all persons who may thereafter furnish labor and materials would take priority over a deed of trust which the owner proposes to give to the lender. Even though the owner may have plans and specifications for the lender to examine, the cost of the project, and hence the amount of the liens which will take priority over the deed of trust, cannot be calculated with certainty. Rising costs of labor and materials, weather conditions, possible bad business judgment on the part of the owner, the chance that some of the numerous original contractors and their subcontractors may divert funds to unauthorized purposes, are among the factors contributing to the uncertainties. It would, of course, be possible to pay off the person

34. A different view is expressed in Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 695, (1972).

35. Tex. Laws 1971, ch. 231, § 2, at 1082-83.

who has done the excavation work and, if *McConnell v. Mortgage Investment Co.*³⁶ is still good law, the lender could then be assured that he is getting first lien. But there is no certainty that the case will be followed. The policy there announced, which favors security in titles and business transactions, has been abandoned in more recent cases, in favor of a liberal construction of the statutes benefitting materialmen and other lien claimants. It is entirely possible that *McConnell* will be either overruled or confined to its precise facts.

Another possible solution for owner and lender is to obtain an agreement from the excavation contractor by which he subordinates his lien to that of the deed of trust. If there is a single lien in which all subsequent contractors will participate, it may be that such an agreement would be binding on all others.³⁷ If, on the other hand, each original contractor has a right to control his portion of the single lien, it is difficult to see how the subordination agreement could bind those who are not parties to it. In the situation described, where some work has been done or some materials furnished prior to the execution of a deed of trust, the building project may be completely frustrated if the reasoning in the first *Alltex* opinion has not been invalidated by the amendment.

If the desired construction is given to the amended statute, these problems can be avoided. The statute lists the events which will result in the inception of "the lien." This could be construed as meaning that there is one lien in which any number of original contractors may share, as the court seemed to hold in the *Oriental Hotel* case. But, on the other hand, no violence is done to the language of the statute if it is held that the statute contemplates a separate lien for each original contractor, each of which has its own inception date for priority purposes. This construction would be in harmony with the language of the equality statute,³⁸ which places all "liens" on an equal footing, although possibly not in accord with the object which that statute may have been designed to obtain. The statutes, however, can be reconciled by a holding that all liens on a particular project which have inception dates prior to the recording of a deed of trust are on an equal

36. 157 Tex. 572, 305 S.W.2d 280 (1957). The case held that when persons doing the earliest work on the job had been paid in full before a deed of trust was recorded, the liens of those who furnished labor and materials subsequent to such recording were inferior to the deed of trust lien. *Id.* at 585, 305 S.W.2d at 288.

37. See *Regold Mfg. Co. v. Maccabees*, 348 S.W.2d 864, 867 (Tex. Civ. App.—Fort Worth 1961, writ ref'd n.r.e.).

38. TEX. REV. CIV. STAT. ANN. art. 5468 (Supp. 1974).

footing "without reference to the date of filing the account or affidavit claiming a lien."³⁹ Stated in another way, the "equality" statute can reasonably be construed as meaning that all liens which have an inception date prior to the recording of a deed of trust, are to be assigned a common inception date and are to be treated equally without reference to which of them was first perfected by the filing of an affidavit.

The single lien theory logically leads to other anomalies. An example is the constitutional lien accorded to most original contractors which, as between the parties to the contract, requires no notice nor filing in order to fix and secure the lien.⁴⁰ The contractor must file an affidavit claiming the lien, however, if it is to be enforceable against subsequent purchasers for value without notice.⁴¹ Suppose O, the owner, contracts with M for materials of a value of \$200, and with various other materialmen and contractors whose claims total \$20,000. M records an affidavit setting out his claim. None of the other claimants file affidavits within the time required by statute. A purchaser from O examines the records, pays off the claim of M, and buys the property without notice of the other claims, which can no longer be perfected. If there is one lien, in which all original contractors participate, has "the lien" as to all claimants been preserved by the timely filing by M? If so, the policy behind the statute requiring filing and recordation has been largely defeated. Moreover, such a result would be inconsistent with the well established rule that, where there is a general contract, timely notice and filing by one derivative claimant does not inure to the benefit of other derivative claimants,⁴² a situation in which the "single lien" concept is much more persuasive.

If there is but one lien in which all original contractors share, would the filing of a suit by one of them interrupt the running of the limitation statute against other original contractors who did not join in the suit? Would actual notice of an unrecorded deed of trust on the part of the first original contractor affect with constructive notice other original contractors with whom he had no connection? The concept of a separate lien for each original contractor, with its own date of inception, to be perfected or neglected, enforced, compromised or released as the particular claimant might elect, would produce a more

39. *Id.*

40. *Strang v. Pray*, 89 Tex. 525, 529, 35 S.W. 1054, 1056 (1896).

41. *Id.* at 529, 35 S.W.2d at 1056.

42. *First Nat. Bank v. Lyon-Gray Lumber Co.*, 110 Tex. 162, 175, 217 S.W. 133, 135-36 (1919); *Bauman v. Cibolo Lumber Co.*, 226 S.W.2d 210 (Tex. Civ. App.—San Antonio 1950, no writ).

manageable system avoiding many such complexities. It would be entirely consistent with this interpretation to hold that any claimant who supplied labor or material to an original contractor, either directly or through a subcontractor, enjoys the same inception date as the contractor under whom his claim was derived, as has been generally supposed to have been true in the past.⁴³

PROBLEMS RELATING TO STATUTORY RETAINAGE

Article 5469, enacted in 1909, and amended in 1961 requires the owner to retain, until 30 days after completion of the work, 10 percent of the contract price to the owner . . . of such work, or ten percent (10%) of the value of the same, measured by the proportion that the work done bears to the work to be done, using the contract price or, if none, the reasonable value of the completed work as a basis of computing value.

The most reasonable explanation for the enactment of the statute seems to be that of protecting those persons who furnish labor and materials at a time when the project is nearing completion. An artisan who furnishes labor at the beginning of the job, such as for the construction of the foundation of the building, will ordinarily have a substantial amount of time before he is required to give any notices. If the artisan deals directly with the contractor, he has 90 days after the 10th day of the month next following the month in which he furnished his labor and materials.⁴⁴ If another artisan furnished all of his labor in the last month of construction, *e.g.* for painting, he theoretically has the same 90-day period within which to give a notice to the owner, but as a practical matter, would often receive no benefit from the lien statutes in the absence of article 5469. This is because the owner frequently pays to his general contractor the balance owing on the contract price upon completion and acceptance. Thus, if the painter does his work in the last week of August, and payment is made by owner to contractor on September 1, the painter may have had less than a week to ascertain whether he is going to be paid by the contractor and to take effective action, for even though his notice to owner is within the time required by statute, it impounds no funds if the owner has properly paid out everything that he owes. That this was the probable purpose

43. See Note, 9 HOUS. L. REV. 174, 175 (1971); Comment, *Priority of Mechanics' and Materialmen's Liens in Texas*, 40 TEXAS L. REV. 872, 884 (1962). See also article 5460, with respect to the nature of the rights of derivative claimants in the homestead situation.

44. TEX. REV. CIV. STAT. ANN. art. 5453, § 1 and art. 5467, § 1(c) (Supp. 1974).

of article 5469, to protect the individual artisans and mechanics who perform work at a time when the project is nearing completion, is evidenced by the fact that the only persons who were benefited by it were artisans and mechanics. Apparently the thinking of the legislature was that subcontractors and materialmen were more likely to be informed about the workings of the statutes, and hence in a better position to protect themselves.

In its original form the statute caused little trouble, and was generally ignored. This is probably because artisans and mechanics are usually in no position to extend credit for their wages, and so continue to be paid until the time when the contractor or subcontractor who employed them actually abandons the work. One case involving the statute, prior to its amendment, did construe it as a departure from the general rule that the owner is not liable for more than the contract price unless he fails to retain funds after having received notice of an unpaid claim.⁴⁵

The amendment in 1961 preserved a priority in the 10 percent retainage for artisans and mechanics, but provided that after they had been satisfied, any other persons might share ratably in the balance remaining.⁴⁶ The amended statute has been the source of considerable litigation, and will no doubt continue to be in the future.

One of the problems, apparently now resolved, was whether, in the absence of a general contract, there was a single retainage fund to be shared by all claimants, or several such funds. This problem can be illustrated by the following example. Suppose Owner does not employ a general contractor, but enters into direct contracts with a number of different persons who would normally be subcontractors. Owner also purchases materials from several different suppliers. C enters into a contract with Owner to furnish all labor and materials for the cement work for a price of \$49,500. He completes his contract during the early part of construction and is paid by the owner in full, the owner having no notice that C has not paid for his materials. The building is completed at a total cost of \$500,000. The owner has retained nothing, but has paid all of his contractors, employees and materialmen in full. Within the time permitted by the statute, a materialman files an affidavit claiming a lien in the amount

45. *Miller v. Harmon*, 46 S.W.2d 342, 346 (Tex. Civ. App.—Austin 1932, no writ).

46. TEX. REV. CIV. STAT. ANN. art. 5469 (Supp. 1974).

of \$20,000 for materials furnished to the cement contractor.⁴⁷ Is Owner's liability limited to 10 percent of the price fixed by the contract with the cement contractor, to whom the materials were furnished, or is Owner liable to this materialman for up to 10 percent of the cost or value of the completed building? In the fact situation supposed, Owner would be liable to the supplier for the \$20,000 if his obligation to that person was to retain 10 percent of the cost of the building, but his liability is limited to \$4,950 if the obligation to this materialman extended only to 10 percent of the contract price for the cement work.

The question was one on which the courts of civil appeals had differed. In *Hunt Developers, Inc. v. Western Steel Co.*⁴⁸ it was held that the owner was required to retain 10 percent of "the entire contract price of the building."⁴⁹ There was, of course, no contract for the entire building, so presumably the court meant 10 percent of either the cost of the completed building or the value of the completed building. In *Lennox Industries, Inc. v. Phi Kappa Sigma Educational & Building Association*⁵⁰ the opposite conclusion was reached on the basis that the statute which defines the term "original contractor" states that there may be "one or more original contractors."⁵¹ Thus, according to *Lennox*, by requiring retention of a percentage of the contract price, it must have been intended that the owner retain 10 percent of the price of each individual contract which would in effect create as many separate funds as there are contracts.⁵²

In *Hayek v. Western Steel Co.*,⁵³ the supreme court in a 5-4 decision, held that the statute requires the owner to retain 10 percent "of the cost or value" of the completed building.⁵⁴ This resulted in a single fund in which any derivative claimant might share without any limitation being imposed by the price of the contract under which he furnished labor or materials. In the fact situation set out above, the claimant was entitled to recover the entire amount of his claim instead of being limited to \$4,950, or 10 percent of the price fixed by the

47. The illustration approximates the facts in *Hayek v. Western Steel Co.*, 478 S.W.2d 786 (Tex. Sup. 1972).

48. 409 S.W.2d 443 (Tex. Civ. App.—Corpus Christi 1966, no writ).

49. *Id.* at 449.

50. 430 S.W.2d 404 (Tex. Civ. App.—Austin 1968, no writ).

51. *Id.* at 408, citing TEX. REV. CIV. STAT. ANN. art. 5452, § 2(e) (Supp. 1974).

52. *Lennox Indus., Inc. v. Phi Kappa Sigma Educ. & Bldg. Ass'n*, 430 S.W.2d 404, 408 (Tex. Civ. App.—Austin 1968, no writ).

53. 478 S.W.2d 786 (Tex. Sup. 1972).

54. *Id.* at 795.

contract between the owner and the claimant's customer. The court and apparently the parties assumed that, prior to the 1961 amendment, a single fund was contemplated.⁵⁵ It was argued that substitution of the word "work" for "house, building, fixture or improvement, in the 1961 amendment indicated an intention on the part of the legislature to change the measure of retainage to 10 percent of each individual contract. This contention was rejected primarily because another of the statutes dealing with mechanics', contractors' and materialmen's liens defined "the work" as "the construction or repair of any house, building or improvement whatever."⁵⁶ The real basis of the decision is to be found, however, in the court's interpretation of the legislative intent as expressed in the emergency clause of the 1961 amendments, which criticized "antiquated, vague and ambiguous [statutes and conflicting decisions] resulting in loss of liens through technicalities"⁵⁷ The court's own notion of sound public policy was obviously an important factor in the decision and to the majority, it was inconceivable that the legislature intended to reduce in any manner the protection accorded to laborers and materialmen. Reflecting this public policy stance, the majority opinion stated: "If perfected statutory liens on unpaid labor and material bills result in a loss to someone, the policy of this State requires that it be the owner, at least to the extent of 10% of the cost or value of the house or of the building."⁵⁸

The *Hayek* decision made it extremely hazardous to enter into any kind of construction project except through the device of a single general contract for a turn-key job. The uncertainties, some of which were pointed out in the dissenting opinion, were numerous. Suppose a fact situation, like the one in *Lennox*, where the owner enters into a contract with E for the electrical work at a price of \$10,000, another contract with M for heating, air conditioning and mechanical work for \$10,000, and still another contract with K in the amount of \$80,000 for the balance of the job. Suppose the hypothetical owner does everything he can to comply with the retainage requirements by withholding 10 percent of the amount of each contract. At the end of the job it is learned that, while E and K have paid all of their bills

55. *Id.* at 792-93. The same assumption was made in *Hunt Developers, Inc. v. Western Steel Co.*, 409 S.W.2d 443, 449 (Tex. Civ. App.—Corpus Christi 1966, no writ).

56. *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 792 (Tex. Sup. 1972), quoting TEX. REV. CIV. STAT. ANN. art. 5452, § 1 (Supp. 1974).

57. Tex. Laws 1961, ch. 382, § 14, at 872.

58. *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 795 (Tex. Sup. 1972).

for labor and materials, M has paid nothing. Under the *Hayek* decision, there is a single fund of \$10,000 which has been created by withholding 10 percent from each contractor (\$1,000 from E, \$1,000 from M and \$8,000 from K). The owner, however, has properly paid out to each contractor the balance of the contract price without notice of any claims. *Hayek* holds that the entire \$10,000 is to be paid to persons who supplied labor and materials to M, if that amount is necessary to satisfy their claims. As noted in the dissenting opinion, this gives rise to a dilemma. It would be possible for the court to place the loss on the owner, and to compel him to pay an additional 10 percent over and above the aggregate of his contracts.⁵⁹ The result would be difficult to justify when, as in the given fact situation, the owner had used every precaution and had fully discharged the duties imposed upon him by the statute. Such a holding would indeed constitute a major departure from the historic and fundamental rule that the owner is never required to pay more than the contract price if he does everything the statutes require him to do. The alternative, however, is to take from E and K, who have faithfully paid all of the claims against them, 10 percent of their respective contract prices to satisfy the claims of those who had supplied materials to M without having first made an adequate credit investigation.

Neither of the choices is acceptable. In view of the *Hayek* decision, what could the prudent owner do to protect himself? One method suggested by the majority opinion is that of requiring a bond from each of the persons with whom he contracts.⁶⁰ This would be feasible in the facts supposed, where there are only three contractors involved. However, in the common situation in which the owner is doing the supervisory work and acting as his own general contractor, as was true in *Hayek*, this is not a practical solution. The owner assumes a direct contractual relationship with a great number of persons and the delay involved coupled with other complications, such as the drafting of detailed written contracts with each of them, negate the bond as a workable answer. Such bonds do relieve the owner of certain inconveniences to which he is otherwise subject, but it is the owner who bears the cost. In any event, payment bonds are not required by the statutes and furthermore, a statute requiring a bond would be of doubtful constitutionality.⁶¹

59. *Id.* at 796 (dissenting opinion).

60. *Id.* at 795.

61. The validity of article 5469 has not been challenged. However, the constitutionality of the statute is open to doubt. Florida enacted a somewhat similar statute

The court's suggestion that the owner may protect himself by withholding "an amount equal to 10% of the contract price or value of

which provided that if the owner did not exact a payment bond from his contractor, then the owner was required to retain at least 20 percent of the contract price until the job was completed and he had been furnished with a statement under oath by the contractor that all bills had been paid. This is the substance of our statutes, in that the owner is required to retain 10 percent of the contract price until 30 days after completion by article 5469, but is relieved of this duty by article 5472(b)-7 if a payment bond has been furnished. The Florida statute not only imposed a lien upon the owner's property but subjected him to personal liability. It is not clear whether the Texas statute does so although this is the view taken in *W. & W. Floor Covering Co. v. Project Acceptance Co.*, 412 S.W.2d 379 (Tex. Civ. App.—Austin 1967, no writ). See Youngblood, *Mechanics' & Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 683 (1972); Note, 22 Sw. L.J. 500, 508 (1968). The Florida Supreme Court held the statute unconstitutional and beyond the state's police power because it was "the mere arbitrary exercise of the power of government, unauthorized by the established principles of private right, and not having the sanction of natural justice . . ." *Greenblatt v. Goldin*, 94 So. 2d 355, 358 (Fla. 1957), quoting *Jones v. Great So. Fireproof Hotel Co.*, 86 F. 370, 388 (6th Cir. 1898). There is an inference that the court might have reached the opposite conclusion had the statute not attempted to impose personal liability on the owner. *Greenblatt v. Goldin*, 94 So. 2d 355, 358-59 (Fla. 1957). See Annot., 59 A.L.R.2d 885 (1958). Texas had at one time a statute requiring that a bond be given. What is now article 5453 was amended in 1915 to require every owner to obtain a bond from the contractor and it was stated that if he did so, the owner should not be compelled to pay a greater sum than the price stipulated in the contract, thus leaving the inference that he would otherwise be liable for a greater amount. Tex. Laws 1915, ch. 143, § 1, at 123-24. Another portion of the statute specifically stated that nothing in the Act should be construed as making the owner liable for more than the contract price. *Id.* § 4, at 225. The bond was to be both a performance and a payment bond and was for the benefit of the owner and all derivative claimants; those claimants who had not attempted to perfect liens as well as those who did. *Id.* § 2, at 224. In *Hess v. Denman Lumber Co.*, 218 S.W. 162 (Tex. Civ. App.—Texarkana 1920, writ ref'd), the owner entered into a contract to have a house built on his property. The job was completed and the owner paid all of the contract price as required by the contract. The lumber company which had furnished material to the contractor gave no notice of its claim to the owner and did not attempt to perfect a lien; however, it later sued the owner on a negligence theory for not having obtained a bond as was required by the 1915 statute. The court held that the statute was unconstitutional, pointing out that the owner was not indebted to the materialmen for he had paid to the contractor all that was owing and should not be required to pay twice for the material used in the construction. *Id.* at 164. The opinion reasoned that perhaps the legislature has the power to make a contractor post a bond as a licensing measure, *i.e.*, as a condition of doing business, but it did not attempt to do this. Instead, the statute, as characterized by the court, requires a compulsory contract for the benefit of third persons:

But the law requires the owner to contract with the contractor to give a bond. This is a compulsory contract purely. We think it is beyond the power of the Legislature to require an owner to contract with the contractor to give a bond, as done in this very act, because it is interference with the law of liberty of contract.

Id. at 164. The refusal of a writ by the Texas Supreme Court in the *Hess* case was regarded in later cases as establishing that the act was unconstitutional in toto. *Williams v. Baldwin*, 228 S.W. 554, 557 (Tex. Comm'n App. 1921, jdgmt adopted); *Cobb v. J.W. Allen & Bro.*, 231 S.W. 829, 830 (Tex. Civ. App.—Texarkana 1921, writ ref'd). Other cases holding portions of the statute unconstitutional were *Wright v. A.G. Adams Lumber Co.*, 234 S.W. 878, 879 (Tex. Comm'n App. 1921, jdgmt adopted) and *Equi-*

the building"⁶² is also an alternative presenting practical difficulties. To begin with, was the owner required to withhold 10 percent of the contract price (*i.e.*, of each expenditure to be made, whether for labor or materials, or both), or 10 percent of the value (presumably market value) of the completed building? Obviously, the market value of the building cannot be known until after it is completed, and even then, it would be surprising if qualified experts did not vary by as much as 10 percent on their appraisals. It therefore seems likely that it would be the sum of 10 percent of each contract price for labor or materials that the owner was required to hold. This means, for example, that a materialman who furnished plumbing supplies at the beginning of the job would have to wait until 30 days after completion of the building before he could collect the final 10 percent of the agreed price of the materials. This delay would seem to make little sense from the standpoint of the materialman, unless, of course, persons who furnish labor or material to a materialman (as distinguished from one who furnishes these items to an owner, contractor, or subcontractor, as the latter term is ordinarily used) can obtain a lien on the property.

Whether a person who furnishes labor or materials to a materialman is entitled to a lien is a question that seems never to have been decided in Texas. The lien, however, can be acquired by a "subcontractor"⁶³ and the statutory definition of the term "subcontractor" includes one who has furnished material to a contractor or subcontractor.⁶⁴ Thus, if the question is answered solely from the words of

table *Sur. Co. v. Stemmons*, 239 S.W. 1037, 1040 (Tex. Civ. App.—Dallas 1922, no writ). The earliest case construing the statute, *American Indemn. Co. v. Burrows Hardware Co.*, 191 S.W. 574, 576 (Tex. Civ. App.—San Antonio 1917, no writ) upheld one aspect of the statute after noting that it imposed no obligations on the owner, but this case was in effect overruled by the later decisions. The 1915 statute was, of course, different in several respects from our present statutes, but insofar as they now give the owner a choice between paying for a bond or suffering liability to unknown claimants when he makes payments in accordance with his contract without notice of claims, or gives a negotiable note at the beginning of the work, there is a marked similarity.

In addition to the practical difficulties in furnishing Hardeman Act bonds in the multiple-contractor situation, it has been suggested that under the single fund theory announced in *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 794-95 (Tex. Sup. 1972), the solvent contractor, as principal on the bond assuring payment by his own subcontractor, would have automatically guaranteed the payment of claims under contracts other than his own. —See Note, 11 HOUS. L. REV. 185, 190 (1973).

62. *Hayek v. Western Steel Co.*, 478 S.W.2d 786, 795 (Tex. Sup. 1972).

63. TEX. REV. CIV. STAT. ANN. art. 5452, § 1 (Supp. 1974).

64. *Id.* § 2(f). The word "subcontractor" in ordinary usage means a person who furnishes both labor and materials to fulfill a part of the primary obligation of a con-

the statutes without regard to the consequences, a materialman who furnishes material to another materialman, who in turn supplies it to an owner, contractor or subcontractor, can obtain a lien. A requirement that 10 percent of each bill for materials be withheld would be reasonable if this is the law. It is believed, however, that the statutes would not be so construed. Seldom, if ever, are ordinary building materials sold by a wholesale dealer to a retailer with reference to any particular construction job, and there is apparently a requirement that the goods be sold with an expectation on the part of the seller that they will be used upon a particular tract of land.⁶⁵ Moreover, it would have been unnecessary to expressly grant lien rights to one who specially fabricates materials for a job, as the statute does,⁶⁶ if any supplier of material, however remote, already had such rights.⁶⁷ Most persuasive, however, is the argument that the legislature did not intend to impose unreasonable burdens on either owners or original contractors. In construing a similar statute, the United States Supreme Court said:

Congress cannot be presumed, in the absence of express statutory language, to have intended to impose liability on the payment bond in situations where it is difficult or impossible for the prime contractor to protect himself. The relatively few subcontractors who perform part of the original contract represent in a sense the prime contractor and are well known to him. It is easy for the prime contractor to secure himself against loss by requiring the subcontractors to give security by bond, or otherwise, for the payment of those who contract directly with the subcontractors. But this method of protection is generally inadequate to cope with remote and undeterminable liabilities incurred by an ordinary materialman, who may be a manufacturer, a wholesaler or a retailer.⁶⁸

However logical or illogical the requirement may have been, however, it is clear that the *Hayek* decision imposed upon the owner the duty to withhold 10 percent of each bill for materials, until 30 days

tractor. See *Marek v. Goyen*, 346 S.W.2d 926 (Tex. Civ. App.—Houston 1961, no writ) (distinguishing the terms “subcontractors” and “artisans”).

65. See *Reeves v. York Eng'r & Supply Co.*, 249 F. 513, 517 (5th Cir. 1918); *In re Wigzell*, 7 F. Supp. 463, 464 (W.D. Tex. 1933); *Campbell v. Teeple*, 273 S.W. 304, 307 (Tex. Civ. App.—San Antonio 1925, no writ).

66. TEX. REV. CIV. STAT. ANN. art. 5452, § 1 (Supp. 1974).

67. It does seem probable that a wholesaler who expressly fabricates material for a particular job may obtain a statutory lien even though the materials are furnished through a retailer of materials rather than directly to an owner, contractor or subcontractor.

68. *MacEvoy Co. v. United States ex rel. Calvin Tompkins Co.*, 322 U.S. 102, 110 (1944) (citations omitted).

after completion of the job; otherwise, he could not then have on hand 10 percent of either the cost or the value of the building.⁶⁹ But the only purpose of such withholding, insofar as the materialman was concerned, would be that of diverting part of his money to the benefit of creditors of some contractor or subcontractor. It could well be that any materialmen unwilling to sell supplies on any basis other than cash would have found that the statute would in effect prohibit them from doing business directly with an owner of property.

Although the majority opinion does not state just how the owner was to protect himself by withholding, another possibility is suggested by an argument mentioned in the *Lennox* case. Suppose again, only three original contracts by the owner, one for foundations, one for heating and air conditioning, and one for the balance of the work are in existence. If the one having the contract for the foundation is the first to complete his work, the owner might be authorized to withhold 10 percent of the estimated cost of the entire completed building from this first contractor, so that he would get nothing until 30 days after the completion of the building, and moreover bear all of the risk of nonpayment by the contractors who would follow him on the job. This possible solution was not foreclosed by *Hayek* and might have been the safest avenue of approach from the standpoint of the owner. The unfortunate contractor selected for this special treatment would have been unhappy, understandably, but would have had no remedy if this was what the statute required.

The final method, mentioned by the majority in *Hayek*, by which the owner might protect himself was that of being certain that all contractors and subcontractors have paid their bills, prior to making payments to them. Affidavits of payment are frequently required, but actually furnish protection only if the statements contained in them are true. The typical owner is not in a position to ascertain whether bills have in fact been paid, although any unpaid materialman or subcontractor can with minimum effort discover the identity of the owner and notify him, thus preventing loss to anyone.

The legislature responded to *Hayek* by amending the definition of the word "work," upon which there had been heavy reliance in the majority opinion, and by adding a definition of "contract price." The word "work" is now defined as "any construction or repair, or any

69. See Hemingway, *Property, Annual Survey of Texas Law*, 27 Sw. L.J. 18 (1973).

part thereof, which is performed pursuant to an original contract."⁷⁰ The term "contract price" is defined as "the cost to the owner for any construction or repair, or any part thereof, which is performed pursuant to an original contract"⁷¹ Although the *Hayek* opinion is not mentioned in the emergency clause, it is clear that the amendment was directed primarily to the result of that decision.⁷²

Several wholesome changes should result from the amendment. To begin with, it now seems clear that the owner is required to retain 10 percent of the price of each individual contract for the benefit of those who furnish labor and materials under that particular contract. There is no longer a single fund in the situation where there is more than one original contract. If the cement contractor fails to pay his bills for materials, the supplier has the benefit of 10 percent of the amount of owner's contract for the cement work, but will not, by reason of the retainage statute, participate in the fund that owner has retained by reason of his contract for plumbing or painting. This not only greatly improves the position of the owner, but assures contractors that the 10 percent withheld from each of them will not be diverted to the payment of the bills of others. Moreover, it will be necessary for the owner to withhold the funds for only 30 days after the completion of the segment of the work embraced within that particular contract, rather than 30 days after completion of the entire building project. The claimant must now file his affidavit claiming a lien not later than 30 days after "the work" (the work under that particular original contract) is completed, instead of 30 days after completion of the building, if he is to benefit from the retainage fund.

It should be kept in mind, of course, that the one who supplies materials to the cement contractor is by no means limited to 10 percent of that contract price if he acts with reasonable diligence. By giving prompt notice of his claim, he will, in the ordinary business situation, collect the entire amount of his claim.

While it is not certain, it seems probable that the amendment has resulted in a benefit to materialmen. Under the *Hayek* decision, the

70. TEX. REV. CIV. STAT. ANN. art. 5452, § 2(d) (Supp. 1974).

71. *Id.* § 2(d).

72. The emergency clause reads:

The fact that court construction of Chapter 2, Title 90, has created an unreasonable retainage requirement on owners who enter into original contracts, and that such interpretations have resulted in confusion and uncertainty in the construction industry . . . create an emergency

Tex. Laws 1972, ch. 96, § 3, at 215. A discussion of the *Hayek* decision and an appraisal of the corrective amendment is found in Note, 11 HOUS. L. REV. 185 (1973).

owner was required to retain, until 30 days after completion of the building, 10 percent of the price for each order of materials purchased by him, so that he would have on hand at the time of completion 10 percent of either the cost or the value, whichever was required, of the entire building. As noted, the period of retention was for 30 days after completion of the building, which meant that materialmen would have considerable sums of money tied up over long periods of time. The statute says that the owner must retain 10 percent of "the contract price . . . of such work, or ten per cent (10%) of the value of same" ⁷³ The new definition of "work" is "any construction or repair, or any part thereof, *performed* pursuant to an original contract" ⁷⁴ Thus, the word "work" does not seem to embrace the mere furnishing of materials. More persuasive, however, is the argument that such retention could now serve no purpose. The retention could be of benefit only to one who had furnished labor or materials to the materialman, and if it is correct that such a person is not embraced by the statutes, there could never be an eligible claimant. ⁷⁵ It therefore seems probable that the owner may safely pay all of his accounts with materialmen at the time agreed upon, and that no retainage is necessary.

PRIORITY IN REMOVABLE IMPROVEMENTS

A Texas statute gives the holder of a mechanic's and materialman's lien priority in an improvement as against certain interests in the land which were in existence before the inception of the mechanic's lien. ⁷⁶ As interpreted by the courts, the statute is operative in only those instances in which the improvement can be removed and sold without material injury to the real estate. ⁷⁷

One problem, on which there has been comparatively little litigation, relates to the types of earlier interests which are made inferior to the mechanic's lien by operation of the statute. Does the statute apply when improvements have been made by a tenant or lessee, and the contest is between the claimant of a lien, and the landlord or lessor?

It is generally true that when work is done or material is furnished

73. TEX. REV. CIV. STAT. ANN. art. 5469 (Supp. 1974).

74. TEX. REV. CIV. STAT. ANN. art. 5452, § 2(d) (Supp. 1974).

75. The owner has no duty to retain funds for the benefit of persons who are not entitled to claim liens. *Longford v. Reeves*, 478 S.W.2d 259, 262 (Tex. Civ. App.—Tyler 1972, writ ref'd n.r.e.).

76. TEX. REV. CIV. STAT. ANN. art. 5459, § 1 (Supp. 1974).

77. See discussion in text beginning at note 93 *infra*.

at the instance of the owner of an interest in land, the lien can attach only to that interest. Thus, if the person ordering the work or materials is a lessee, the lien can attach only to the leasehold estate,⁷⁸ which may be of great value or may be worthless. In *Schneider v. Delwood Center, Inc.*,⁷⁹ a corporation, which was the owner of a tract of land, executed a 99-year lease. The lease, which was recorded, disclosed that the parties contemplated that the lessee would erect an apartment complex on the property, although he was not obligated to do so. The lease, however, did not purport to authorize the lessee to act in any way for the lessor in the construction endeavor, nor did the lessor have any control over the construction. The lease did contain an agreement to the effect that the corporation-lessor would subordinate its reversionary interest to a deed of trust to be given by the lessee to some lending institution for the purpose of financing the construction. There was also a clause providing for automatic termination of the lease in the event of the bankruptcy of the lessee. The lessee arranged a construction loan from a mortgage lender, and pursuant to the agreement, the lessor executed an instrument subordinating its rights to those granted the mortgagee by the deed of trust, but the lessor assumed no personal liability for payment of the debt. The buildings were completed, but the lessee-builder diverted some of the money from the deed of trust loan to other purposes, and subsequently was adjudged bankrupt. Several claimants who had supplied labor and materials to the lessee filed affidavits claiming liens. The court held, in line with earlier cases,⁸⁰ that the lien could attach only to the lessee's interest in the property, and since that interest had terminated as a result of the bankruptcy proceedings, the lien claimants had no rights in the property.⁸¹ The lessor was, of course, re-

78. *Grube v. Nick's No. 2*, 278 S.W.2d 252, 253 (Tex. Civ. App.—El Paso 1955, writ ref'd n.r.e.); *Penfield v. Harris*, 27 S.W. 762, 764 (Tex. Civ. App. 1894, writ ref'd). See *Wotola Royalty Corp. v. Bethlehem Supply Co.*, 152 S.W.2d 480, 485-86 (Tex. Civ. App.—Amarillo 1941), *aff'd*, 140 Tex. 9, 165 S.W.2d 443 (1942); *Campbell v. Teeple*, 273 S.W. 304, 306-07 (Tex. Civ. App.—San Antonio 1925, no writ). The same principle was applied in *Kelly v. Heimer*, 312 S.W.2d 430, 434 (Tex. Civ. App.—San Antonio 1958, writ ref'd n.r.e.), which held that work ordered by the holder of an option could not result in a lien against the interest of the owner after the option had expired. In an occasional case, the facts may justify a finding that the lessee was acting as an agent of the lessor in making repairs or improvements, so that the lien attaches to the reversionary interest of the lessor as well as to the leasehold estate. See *Rosen v. Peck*, 445 S.W.2d 241, 247 (Tex. Civ. App.—Waco 1969, no writ).

79. 394 S.W.2d 671 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.).

80. See cases cited note 78 *supra*.

81. *Schneider v. Delwood Center, Inc.*, 394 S.W.2d 671, 677 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.).

quired to pay off the loan secured by the deed of trust in order to prevent a foreclosure, however, this was not an issue in the case.

The issue in the *Delwood* case of particular interest here is whether a materialman who has supplied removable items to a lessee may have them removed and sold apart from the real estate as against the owner of the reversionary interest, assuming, as the court did, that this could be accomplished without injury to the real estate. Such right is expressly given by statute as against "any prior lien or encumbrance or mortgage upon the land."⁸² The court concluded that the statute was inapplicable, not only because its language did not embrace owners of the property, as distinguished from prior lienholders, but because under the express provisions of the lease, the improvements reverted to the owner of the fee.⁸³ The rule is one which could result in the unjust enrichment of the lessor under some circumstances, although it apparently did not do so in the *Delwood* case as the lessor was required to pay off the construction loan, which was apparently for the full cost of the building. In any event, the case seems to establish that the supplier of a fixture to a lessee has no lien on either the land or the fixture that will survive the termination of the leasehold estate, even though the fixture could be removed without material injury to the real estate.

Suppose, however, that a lease gives the lessee the right to remove any fixture installed by him. Would this produce a different result with respect to the lien claim of one who had installed a fixture at the request of the lessee? The lien claimant receives no benefit from article 5459 because of the holding in *Delwood* which construed the statute as not applying to a contest between an owner and one who claims a mechanic's and materialman's lien. In *Penfield v. Harris*,⁸⁴ the lessee apparently did have the right of removal, conditioned upon his having paid all of the rent owed, although the condition was not performed. In holding that one who had supplied machinery to the lessee and properly filed an affidavit claiming a lien had no rights as against the owner, the court said:

Plaintiffs in error had no kind of lien on the property . . . because [the lessee] did not own the land; and, if the property [machinery] did not become improvements on the land, then the

82. TEX. REV. CIV. STAT. ANN. art 5459, § 1 (Supp. 1974).

83. *Schneider v. Delwood Center, Inc.*, 394 S.W.2d 671, 677-78 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.).

84. 27 S.W. 762 (Tex. Civ. App. 1894, writ ref'd).

lien could not attach, because the lien for material cannot attach independent of connection with the land.⁸⁵

Possibly, the result would have been different if the tenant had performed the condition which would have given him the right of removal. It is generally accepted that the lien can attach to a leasehold estate, and therefore arguable that, if the tenant had a reasonable time after termination of the lease to remove a fixture, this was a part of the leasehold estate to which the lien of the supplier of the fixture also attached. If the supplier is permitted to enforce his lien on a fixture, the owner-lessor is in no worse position than he would have been in had the lessee paid for the fixture, and then removed it upon the expiration of the lease.⁸⁶

If the seller of a chattel, which is to be annexed to real estate in such a way as to become a fixture, is dealing with a tenant or lessee, it would be advisable for him to take a purchase money security interest in the chattel and to perfect it by a fixture filing.⁸⁷ By doing so, he assures himself of priority, insofar as the chattel is concerned, against both the lessor-owner and most prior liens on the land.⁸⁸ Moreover, he may also have a constitutional lien on the chattel and the tenant's leasehold estate, if that estate has survived. Although one case contains a statement to the contrary,⁸⁹ it is unlikely that the reservation of a security interest in the chattel would be held to be a waiver of the liens given by the constitution and statutes.⁹⁰ He could therefore elect the remedy that appeared to be most advantageous at the time of default by his purchaser. Having perfected his security interest by a fixture filing, the supplier would have the right to remove the fixture even though some damage to the real estate would result, but he would be required to pay the costs of any repairs.⁹¹

Controversies that are frequently encountered are those which arise between the materialman or subcontractor and the holder of a prior

85. *Id.* at 764.

86. Compare TEX. BUS. & COMM. CODE ANN. § 9.313(e)(2) (Supp. 1974).

87. *Id.* § 9.402(a) (Supp. 1974).

88. *Id.* § 9.313(d)(1) (Supp. 1974). The security interest in the fixture would not have priority over a previously recorded deed of trust given to secure a construction loan if the fixture is installed during the course of construction. *Id.* § 9.313(f). This would seldom occur, however, when a fixture is sold to a lessee or tenant.

89. *De Bruin v. Santo Domingo Land & Irr. Co.*, 194 S.W. 654, 656-57 (Tex. Civ. App.—San Antonio 1917, writ ref'd).

90. *Farmers & Mech. Nat. Bank v. Taylor*, 91 Tex. 78, 40 S.W. 966 (1897). See Annots., 58 A.L.R. 1121 (1929); 65 A.L.R. 282, 305 (1930).

91. TEX. BUS. & COMM. CODE ANN. § 9.313(h) (Supp. 1974).

lien on the real estate. On one hand, the real estate mortgagee should not have his security diminished by the construction of improvements on the land. Conversely, he should not have his security enhanced at the expense of those who may later furnish labor and materials for improvements.⁹² In a general way, at least, these propositions are recognized by the Texas statute.

Article 5459 states that the lien of the mechanic or materialman shall attach to the improvements for which the labor or material was furnished in preference to any prior lien on the land, and that the claimant may have such building or improvement sold separately, apart from the land. But the statute further states that the prior lien shall not be affected by such sale. There was once a conflict among Texas cases as to whether the statute was applicable when the improvement was of such a nature that it could not be removed from the land without injury to it, or to a preexisting structure. When the improvements could not be sold apart from the real estate, it was held in some of the early decisions that the land and the improvement were to be sold together, and that the proceeds were to be prorated so as to give priority to the holder of the mechanic's lien to the extent that the improvement had enhanced the value of the property.⁹³ It is now established that the statute giving priority to the improvement is applicable only when the improvement is of such a nature that it can be removed from the real estate without material injury to the improvement, the land or to the preexisting structure upon which the improvement was made.⁹⁴ Although the rule is simple, its application may not be.

Article 5459 does not create liens. It merely regulates the priority between the lien granted by article 5462 and prior liens and encumbrances on the real estate. If a claimant is asserting a lien under the statutes, he must show that he has taken the necessary steps to affix his lien, because article 5459, standing alone, gives him no rights against prior lienholders.⁹⁵ It should also be remembered that the

92. See Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 696 (1972).

93. *Brown v. Webb*, 1 S.W.2d 1102, 1108 (Tex. Civ. App.—El Paso 1928, no writ); *Kahler v. Carruthers*, 45 S.W. 160, 165 (Tex. Civ. App. 1898, writ ref'd).

94. *Hammann v. H.J. McMullen & Co.*, 122 Tex. 476, 484, 62 S.W.2d 59, 61-62 (1933); *Cameron County Lumber Co. v. Al & Lloyd Parker Inc.*, 122 Tex. 487, 490, 62 S.W.2d 63, 64 (1933); *Chamberlain v. Dollar Sav. Bank*, 451 S.W.2d 518, 520 (Tex. Civ. App.—Amarillo 1970, no writ).

95. *Home Sav. Ass'n v. Southern Union Gas Co.*, 486 S.W.2d 386, 392 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.).

claimant's lien extends to the land as well as to the improvement. Article 5459, if applicable, however gives the claimant a preferred lien with respect to the improvement only. If the statute does not apply, the claimant is not deprived of his lien against the property as a whole; he is simply relegated to an inferior position as to other interests in the property which were prior in point of time.

Courts have sometimes overlooked the fact that in the usual case there can be no lien on the improvement, aside from one created by contract, unless the lien also attaches to the real estate. Occasionally a supplier of a chattel may have manufactured it to the order of his customer, and thus be entitled to a constitutional lien on the chattel as such. Instances of this kind are rare, however, and only one case has been found in which the constitutional lien on chattels has been accorded to a manufacturer of a chattel, as distinguished from one who repairs it.⁹⁶ In cases where the chattel has been improved or repaired there exists the mistaken notion that the lien may attach to the chattel alone, which seems to be based on language in several cases⁹⁷ to the effect that improvements which are severable are treated, for priority purposes, as if they had never become part of the real estate.⁹⁸ But as stated by one writer, while this may add to an understanding of how the improvements may be sold apart from the real estate, if used only as an analogy, an acceptance of the proposition for all purposes leads to a logical impasse. "The logical result of this analysis is that a claimant who establishes facts which give his lien a preference has ipso facto established that he is entitled to no lien at all."⁹⁹ In *First National Bank v. Whirlpool Corp.*,¹⁰⁰ the plaintiff had sold to the owner garbage disposers, dishwashers, electric ranges, and refrigerators for use in an apartment complex. The latter two items were in no way attached to the buildings, connected only in the sense that the cords attached to them could be plugged into wall outlets in the buildings. It was held that plaintiff had a lien, superior to that of an earlier deed of trust, for all of the items furnished.¹⁰¹ The court was obviously correct in holding that the stoves and refrigerators could be

96. *Wichita Falls Sash & Door Co. v. Jackson*, 203 S.W. 100, 101 (Tex. Civ. App.—Amarillo 1918, no writ). See Woodward, *The Constitutional Lien on Chattels in Texas*, 28 TEXAS L. REV. 305, 318 (1950).

97. See, e.g., *Somerville v. King*, 98 Tex. 332, 83 S.W. 680 (1904).

98. *Id.* at 338, 83 S.W. at 682.

99. Youngblood, *Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 697 (1972).

100. 502 S.W.2d 185 (Tex. Civ. App.—Waco 1973, writ granted).

101. *Id.* at 193-95.

removed without injury to the building, but incorrect in holding that they could be the subject matter of a mechanic's and materialman's lien on the real estate. There is no indication in the opinion that the point was argued, possibly because the holder of the deed of trust on the real estate also had no lien on items which were purely chattel in character.¹⁰² It does seem clear that the refrigerators and ranges were not "material, machinery, fixtures or tools *incorporated* in the work, or *consumed* in the direct prosecution of the work," and were therefore not within the statutory definition of "materials."¹⁰³ Nor were they furnished for "the construction or repair of any . . . building."¹⁰⁴ If the corporation that sold the stoves and refrigerators was also the manufacturer of them, there is some basis for arguing that it had a constitutional lien on the chattels themselves, apart from the real estate.¹⁰⁵ It is also arguable, however, that the constitutional lien on "articles made or repaired"¹⁰⁶ will be confined to situations where chattels have either been repaired, or have been manufactured especially for a customer pursuant to a special order.¹⁰⁷ In any event, if a constitutional lien exists on the chattels themselves, apart from the real estate, the real estate mortgagee would have no valid claim of a lien on these items which had never become a part of the land, and article 5459 would have no application.

Whether article 5459 regulates priority issues as between the holder of an unperfected constitutional lien on real estate and a prior lien on the land seems never to have been decided, but dictum in one case states that it does not.¹⁰⁸ If this dictum is followed, the "first in time,

102. The opinion does state that the owner executed a security agreement with the mortgagee-bank about 7 months after the recording of the bank's deed of trust. The items covered by the security agreement are not disclosed, nor is there any mention of whether the security agreement was perfected. *Id.* at 188.

103. TEX. REV. CIV. STAT. ANN. art. 5452, § 2b(1) (emphasis added). See *Reeves v. York Eng'r & Supply Co.*, 249 F. 513, 517 (5th Cir. 1918); *McConnell v. Frost*, 45 S.W.2d 777, 780 (Tex. Civ. App.—Waco 1931, writ ref'd); *Campbell v. Teeple*, 273 S.W. 304, 307 (Tex. Civ. App.—San Antonio 1925, no writ).

104. TEX. REV. CIV. STAT. ANN. art. 5452, § 1 (Supp. 1974). See *Youngblood, Mechanics' and Materialmen's Liens in Texas*, 26 Sw. L.J. 665, 673 (1972).

105. See *Woodward, The Constitutional Lien on Chattels in Texas*, 28 TEXAS L. REV. 305, 318 (1950).

106. TEX. CONST. art. XVI, § 37.

107. See *Wichita Falls Sash & Door Co. v. Jackson*, 203 S.W. 100, 101 (Tex. Civ. App.—Amarillo 1918, no writ).

108. *Home Sav. Ass'n v. Southern Union Gas Co.*, 486 S.W.2d 386, 392 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.). The statement was unnecessary to the decision as the real estate mortgagee had made advances to the owner in large amounts subsequent to the inception of the unperfected constitutional lien, and without actual notice of its existence. *Id.* at 388-89.

first in right" maxim is controlling. The question will not often arise because of the very considerable length of time granted to an original contractor to file his affidavit claiming a lien, and thus to acquire a statutory lien, as well as the lien granted by the constitution. Whether a particular improvement may be removed without substantial injury to the real estate is generally a question of fact. Oddly enough, the statute provides that this issue may be tried, at least initially, in a proceeding to which the prior lienholder is not a party.¹⁰⁹ Of course, if the prior lienholder is not a party to the proceeding, he would not be precluded by a judgment adversely affecting his rights.

Sometimes there is little occasion for doubt as to whether a particular improvement will be held to be removable. If the improvements are of such a nature that their removal will destroy their value, so that the right of the materialman to remove them would have value only as leverage in trying to work out a trade with the prior lienholder, the cases are consistent in holding that they are not subject to removal. In cases of this type, the character of the competing lien is of no importance. Illustrative of this type of case is an improvement consisting of cement work, the value of which would be entirely destroyed if it were removed;¹¹⁰ similarly, paint and wallpaper, which could have no value if detached from the walls, are clearly not removable.¹¹¹ In another class of cases, it is quite clear that the improvement can be removed without physical injury to either the land or to any structure located on the land, and that the improvement in question, usually a fixture, was supplied and installed solely by the one claiming the lien. If the holder of the prior mortgage did not advance funds which were used to make partial payment for the improvement, his lien will not be impaired by its removal, and there would be no difficulty in deciding that it should be severed from the real estate and sold apart from it. Aside from cases of this class, it is often hard to predict whether a particular improvement will be regarded as removable. The cases are difficult to reconcile if read solely in light of the physical damage which would result from a severance of the improvement from the real estate.¹¹²

109. TEX. REV. CIV. STAT. ANN. art. 5459, § 1 (Supp. 1974). See *Bankers Life Co. v. John E. Quarles Co.*, 131 Tex. 65, 68, 112 S.W.2d 1044, 1046 (1938).

110. *Hammann v. H.J. McMullen & Co.*, 122 Tex. 476, 62 S.W.2d 59 (1933).

111. *Quinn v. Dickinson*, 146 S.W. 993 (Tex. Civ. App.—Amarillo 1912, no writ). See also *Citizens Nat'l Bank v. Strauss*, 69 S.W. 86 (Tex. Civ. App. 1902, writ ref'd) (new roof held not a removable fixture).

112. The cases are collected and discussed in Youngblood, *Mechanics' and Material-men's Liens in Texas*, 26 Sw. L.J. 665, 696-97 (1972).

For example a frame building has been held to be removable in one case,¹¹³ but not in another.¹¹⁴

The courts have drawn a distinction, at least in dictum, between a case where the prior lien has been on a vacant tract of land, and one in which a repair or improvement is made to a structure to which the earlier lien had attached. When, for example, a vendor sells unimproved land and retains a lien for the purchase money, he has bargained only for a security consisting of the land itself. To the extent that his security is enhanced by the addition of improvements, he obtains a benefit that he had no right to expect and, if he is postponed in priority to the one who later makes the improvement, he has no cause for complaint.¹¹⁵ Apparently, the purpose for which the prior lien on the real estate was given, that is, the type of loan secured by it, has influenced the decisions in some of the cases, and rightfully so, although this has not always been articulated in the opinions. The statute gives the claimant of the mechanic's lien priority in a removable improvement, but it also states that any prior lien or encumbrance "shall not be affected thereby,"¹¹⁶ which is another way of saying that the security of the prior lienholder is not to be impaired. It therefore seems entirely proper for the courts to hold that a particular type of improvement is severable under one set of circumstances but not in another. Whether the prior lien will be "affected" should depend upon its character.

In *Chamberlain v. Dollar Savings Bank*,¹¹⁷ the owner of a lot obtained a commitment for a construction loan, and executed a note for the full amount, together with a deed of trust, which was recorded. Thereafter plaintiff furnished brick to be used in the construction of veneer walls and the fireplace. Advancements by the construction financier were made in installments, some before, and some after, the inception of plaintiff's lien. Here, of course, the materials were incorporated into the structure on which there was a prior lien, and it was held that

113. *Wallace Gin Co. v. Burton-Lingo Co.*, 104 S.W.2d 891, 892 (Tex. Civ. App.—Austin 1937, no writ). See also *J.D. McCollum Lumber Co. v. Whitfield*, 59 S.W.2d 1106, 1107 (Tex. Civ. App.—Austin 1933, writ ref'd); *William Cameron & Co. v. Trueheart*, 165 S.W. 58, 60 (Tex. Civ. App.—Austin 1914, no writ).

114. *Irving Lumber Co. v. Alltex Mortgage Co.*, 446 S.W.2d 64, 69 (Tex. Civ. App.—Dallas 1969), *aff'd*, 468 S.W.2d 341 (Tex. Sup. 1971).

115. See *Freed v. Bozeman*, 304 S.W.2d 235 (Tex. Civ. App.—Texarkana 1957, writ ref'd n.r.e.); *J.D. McCollum Lumber Co. v. Whitfield*, 59 S.W.2d 1106 (Tex. Civ. App.—Austin 1933, writ ref'd); *William Cameron & Co. v. Trueheart*, 165 S.W. 58, 60 (Tex. Civ. App.—Austin 1914, no writ).

116. TEX. REV. CIV. STAT. ANN. art. 5459, § 1 (Supp. 1974).

117. 451 S.W.2d 518 (Tex. Civ. App.—Amarillo 1970, no writ).

they could not be removed without substantial damage to the building.¹¹⁸ Suppose, however, that the competition had been between one who held a vendor's lien on the land, but who had not participated in financing the construction, and the plaintiff who had furnished brick to veneer the walls. If the brick could be removed without structural damage to the building, and at a profit to the supplier, it is at least arguable that removal should be permitted. This would be no more extreme than permitting the removal of an entire house. The holder of the vendor's lien would still have his security enhanced by the value of the incomplete structure, which is more than he bargained for. It is assumed, of course, that the expense of removing and cleaning the brick would not exceed the salvage value. The decision in *Chamberlain* clearly recognizes the interest of the construction mortgagee in the structure as a whole, and denies any right in the lien claimant to diminish the value of the structure by removal of the material furnished by him.

No construction mortgage was involved in *Wallace Gin Co. v. Burton-Lingo Co.*¹¹⁹ Here, the Gin Company executed a deed of trust to secure notes which were apparently for an antecedent debt owed to the mortgagee. The need of trust covered a tract of land on which the gin was located. Some 4 years later, the Gin Company purchased materials from plaintiff for the erection of a cotton house on the land, which was a distinct and separate unit from the existing building. The property was later sold by the trustee named in the deed of trust, but the purchaser at the foreclosure sale bought with both actual and constructive notice of the constitutional lien that had been perfected by plaintiff. The trial court found that the cotton house, for which plaintiff had furnished materials, could be removed and sold separately without material injury to either the land or the structure that had been in existence at the time the deed of trust was executed. The defendant, whose rights had been obtained through the deed of trust, contended that the statute giving priority to the lien of plaintiff with respect to the removable improvement was inapplicable because it was shown that the owner had bought some of the materials elsewhere, and paid for them, and that the materials furnished by plaintiff could not be segregated and removed without destroying the improvement. To this the court replied:

We do not understand the statute to so limit the rights of one

118. *Id.* at 520.

119. 104 S.W.2d 891 (Tex. Civ. App.—Austin 1937, no writ).

who furnishes materials. If that were true, in many cases the liens and rights of the materialman could and would readily be defeated, for the reason that in many, if not most, instances no one concern furnishes all such materials, and manifestly it is seldom true that all of the materials which go into the construction of such improvements are furnished on credit.¹²⁰

It was also pointed out that neither the mortgagee in the deed of trust nor the purchaser at the sale had furnished any of the other materials that went into the structure and that the property was in the same condition it was when the deed of trust attached.¹²¹ As applied to the facts of the case, this interpretation of the statute achieves a just result for the holder of the prior deed of trust had the same security that he bargained for, that is, the land and the building which was on it at the time the deed of trust was taken.

Had there been other unpaid materialmen or laborers, the court would have no doubt ordered an apportionment of the proceeds from the sale of the removed improvement, giving to each equality in priority on a pro rata basis.¹²² But if the house had been an existing structure, to which the lien of the deed of trust had attached before the inception of the mechanic's lien, a different question would have been presented, and it seems clear from the opinion that the mechanic's lien would have been superior only if the plaintiff's materials could have been removed without injury to the structure.

The result should also be different in a case where the prior deed of trust was to secure a loan for construction of the improvement, at least if the proceeds of the loan are in fact used for that purpose. No Texas case has been found which gives express consideration to the special nature of the construction mortgage, but it should be treated in the same way as a mortgage on an existing structure which is later repaired or improved. When a construction mortgage is given, the land itself is seldom, if ever, adequate security for the loan. The security is to be obtained in the completed building. Accordingly, it is difficult to conceive of any reason why one who furnishes part of the materials for a building should be preferred over another whose money has been used to pay for most of the labor and materials that have gone into the structure. The validity of this reasoning seems to have received legislative recognition in the recent revision of the part of the *Uniform*

120. *Id.* at 892.

121. *Id.* at 892.

122. TEX. REV. CIV. STAT. ANN. art. 5468 (Supp. 1974).

Commercial Code dealing with priorities for fixtures. The construction mortgage on the real estate under the Code is accorded complete priority over security interests in fixtures which are installed during the course of construction.¹²³

If considered solely from the standpoint of achieving a just result in an individual case, the ideal solution would be to treat the prior construction mortgagee and the materialman equally, giving to each a pro rata share of the proceeds of the sale of the improvement. One claimant has contributed his goods or materials, the other his money, and it is difficult to see how one should be preferred over the other. This solution may not be possible under the present statute, however, because it has been construed as giving the materialman complete priority as to the improvement, or alternatively, as not applying at all, in which event priority is given to the earlier lien.¹²⁴ Assuming that equality in priority is not a permissible solution, preference should be given to the construction mortgagee whenever possible. This is not an argument that the materialman should be denied his right to collect from the owner, but merely that he should not collect at the expense of the construction mortgagee, without whose funds there would have been no construction project.¹²⁵ Seldom, if ever, does the owner of property pay cash for a major improvement. He must obtain financing, and in most instances from two sources. Usually, he obtains a commitment for a long term loan from a mortgage lender who is unwilling to advance anything until the building is completed. The funds actually expended in the construction must be obtained from an interim financier. The availability of such funds is critical to the economic health of all segments of the building industry, as well as to the housing needs of the public. Recognition of the construction mortgage as being in a special category in regard to priority over mechanic's and materialmen's liens would be an encouragement to interim lenders, which would lead to an increase in building. It would not be necessary for the courts to re-write the statute for it expressly states that the priority accorded to subsequent lien claimants is limited to the situation where no prior lien "shall be affected thereby." Implementation

123. TEX. BUS. & COMM. CODE ANN. § 9.313(f) (Supp. 1974).

124. See *Hammann v. H.J. McMullen & Co.*, 122 Tex. 476, 484, 62 S.W.2d 59, 62 (1933); *Cameron County Lumber Co. v. Al & Lloyd Parker Inc.*, 122 Tex. 487, 490, 62 S.W.2d 63, 64 (1933); *Chamberlain v. Dollar Sav. Bank*, 451 S.W.2d 518, 520 (Tex. Civ. App.—Amarillo 1970, no writ).

125. Scholl, *Priorities Between Mechanics' Liens and Construction Loan Mortgages in Alabama*, 23 ALA. LAW. 398, 435-36 (1962).

of the intent of the statute can be most easily achieved through a recognition that a particular improvement may be removable or not, depending on the character of the debt secured by the earlier mortgage.

A variation is presented in cases in which a construction mortgage is given and recorded before the inception of any lien for labor or materials, but the construction loan funds are wrongfully diverted by the owner to purposes other than payment for labor and materials for the building. In *Parkdale State Bank v. McCord*¹²⁶ a deed of trust was given to secure a construction loan and recorded prior to the time any labor or materials were furnished. When plaintiff commenced work, the owner had completed sidewalks, driveways and foundation slabs, and had paid for them. Plaintiff then fabricated and installed on the foundations, wall sections, window units, outside door units, roofs, outside wall sheeting and related materials. The remaining construction work was done by others who were paid by the owner, although the source of the funds for such payment is not specified in the opinion. The court states that little, if any, of the funds from the construction loan were used to pay for labor and materials in 1965, the year in which the funds were advanced, but there is a confusion of dates in the opinion, and it is not clear whether the loan funds were diverted to other purposes, and never applied to the cost of construction, or only that none of them were so used when, or shortly after, they were advanced. The deed of trust was foreclosed and the mortgagee was the purchaser at the sale. Thereafter the plaintiff, who was the only unpaid claimant, sued for a foreclosure of his mechanic's and materialman's lien. The trial court found that the houses could be removed from the slab foundations and sold apart from the real estate without injury to the land or to the foundations. The decree ordering a sale of the houses apart from the foundations was affirmed with the contention that the houses were not removable, because plaintiff did not supply all of the labor and materials for their construction, being rejected on the authority of the *Wallace Gin Co.* case.¹²⁷ Whether that case should be controlling depends on whether any substantial amount of the construction loan went into the payment of labor and materials for the building, a fact that cannot be discerned from the opinion. If funds advanced by the mortgagee were used to pay for the other labor and materials that went into the completion of the houses, it should have been held that the improvements could not be removed and sold

126. 428 S.W.2d 121 (Tex. Civ. App.—Corpus Christi 1968, writ ref'd n.r.e.).

127. *Id.* at 126-27.

apart from the land, for the reason that the prior lien would be "affected thereby."

Statutes in several states give special priority treatment to construction mortgages.¹²⁸ Some of them either expressly require, or are interpreted as requiring, that the loan proceeds actually be used for payment of the costs of construction,¹²⁹ while others have no such requirement.¹³⁰ On this question, it would seem that the equities are with the materialman because there is no question that his materials have enhanced the value of the property. If the mortgagee is to be given priority, he should be required to show that the money advanced by him was used for the intended purpose, and his priority limited to the extent that it was in fact so used.

In *First National Bank v. Whirlpool Corp.*¹³¹ the bank made a construction loan for an apartment complex, which was secured by a deed of trust recorded before the inception of any mechanics' and materialmen's liens. Thereafter Whirlpool furnished to the owner household appliances, including garbage disposers and dishwashers, at a total cost of a little over \$39,000. Of this amount, over \$29,000 was paid, presumably out of proceeds of the construction loan. Whirlpool then filed an affidavit claiming a lien for the balance owing, which was nearly \$10,000. It was held that the materialmen's lien was superior to that of the deed of trust because the materials consisted of severable items,¹³² which undoubtedly could have been detached and removed from the buildings without any physical damage to either the buildings or to the appliances themselves. In concerning itself solely with the question as to whether the fixtures could be removed without physical damage to the real estate, a matter about which the statute itself says nothing, the court overlooked the criterion which the statute sets out for a determination of priority, that is, whether the prior lien will be affected. If the real estate mortgagee supplied the funds out of which approximately three-fourths of the price of the fixtures was paid, as seems probable, a holding that the supplier of the fixtures has complete priority in them for the remaining one-fourth of the price is unfair. Moreover, the result does not conform to the statute in that the prior mortgagee is adversely affected.

128. *E.g.*, ARK. STAT. ANN. 51-605 (1947). See G. OSBORNE, MORTGAGES § 216 (2d ed. 1970).

129. See *Joralman v. McPhee*, 71 P. 419, 422 (Colo. 1903).

130. *Chauncey v. Dyke Bros.*, 119 F. 1, 8 (8th Cir. 1902). See G. OSBORNE, MORTGAGES § 216 (2d ed. 1970).

131. 502 S.W.2d 185 (Tex. Civ. App.—Waco 1973, writ granted).

132. *Id.* at 193-95.

CONCLUSION

There are many important and unsolved questions relating to the interrelationship of the mechanics' lien statutes and the newly re-drafted fixture filing provisions of the *Uniform Commercial Code*, and what is written above about removability of improvements is obviously incomplete in failing to consider them. Another major omission is a discussion of unresolved questions with respect to the "future advances" aspects of construction loan mortgages.¹³³ It is a sufficient apology to say that more appears here than the average lawyer, and certainly the average law student, will care to read.

The reader has already concluded, if he did not know it before, that our statutes on mechanics' and materialmen's liens are exceedingly complex. This is true of the statutes of other jurisdictions as well. Variations in business transactions in the construction industry insure the courts difficult tasks in interpreting the most carefully drafted statutes. Due to the impossibility of expressly providing for solutions to every problem, it is believed that these statutes, like others relating to commercial endeavors, should be construed so as to produce a reasonable and workable system. If one segment of the industry is unduly favored at the expense of another, the industry as a whole, and the public at large, will suffer.

133. See Annot., 80 A.L.R.2d 179 (1961).