Study H-820 May 11, 2001

First Supplement to Memorandum 2001-41

Mechanic's Liens: General Revision (Comments of Gordon Hunt)

The Commission has received a detailed commentary from Gordon Hunt, a Commission consultant, concerning the short draft statute proposed by James Acret, which is attached to the main memorandum. We will discuss the points in the letter at the meeting. Mr. Hunt finds that the Acret draft is "too limited and too short and doesn't cover all the issues." See Exhibit p. 7.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

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GORDON HUNT

VIA FACSIMILE

May 11, 2001

Stan Ulrich
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Law Revision Commission

Dear Stan:

Attached is a copy of my letter to Jim Acret concerning his first draft. I believe the correct approach is as set forth in my original report (Part I). If the Commission elects to re-write the entire Mechanic's Lien Law, I will prepare a simplified draft.

I will send another letter commenting on your memorandum dated May 10, 2001 in more detail when time permits.

Very truly yours,

HUNT, ORTMANN, BLASCO,
PALFFY & ROSSELL

Gordon Hunt

GH:slg

Enclosure

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GORDON HUNT

VIA FACSIMILE (213) 623-4742

May 11, 2001

Jim Acret
Thelen Reid & Priest LLP
333 So. Grand Ave., Suite 3400
Los Angeles, CA 90071

Re: **Mechanic's Lien Law Revision**

Dear Jim:

This letter is in response to your e-mail dated January 29, 2001. The following are my comments regarding your first draft of a "Simplified Mechanic's Lien Statute":

1. No. 3 "Charge": You should include a reference to a claim on a payment bond.

2. No. 4 "Assert": You should include a reference to a claim on a payment bond.

3. No. 7 "Service and Proof of Service": Service should be as presently stated in the statute, to-wit, personal service, certified mail or registered mail. As you probably know as a practical matter in the construction industry, many claimants send their Preliminary Notices by certified mail and do not incur the extra expense for return receipt requested. If it becomes necessary, they obtain proof of service from the United States Post Office at a later date. Claimants should have all three of those options, to-wit, personal service, certified mail, or registered mail.

4. No. 7 "Release": I agree that Civil Code §3262 is a complicated piece of legislation. I assume it is your intent, by virtue of the wording of Section 9 as drafted by you, that you intentionally omitted any mention of lien waives at all. The question then arises as to whether or not a release executed separately from a contract would be enforceable. I assume it is your intent to let the "marketplace" prevail, that is, we will go back to the old way of doing business, to-wit, everybody would have their own forms of releases and a great deal of time and effort would be spent between lenders, owner, primes, subs and suppliers as to the "form of the release". If you have examined my original report to the Law Revision Commission, you will see that I

have recommended amending Civil Code §3262 and have, in fact, drafted new release forms to be inserted into the statute. I would suggest that you take a look at my recommendations.

5. No. 10 "Willful Overstatement": You, of course, have no definition as to what a willful overstatement is. Further, your Item No. 10 does not take into account the current Civil Code §3123(b) and the Basic Modular Products' case. It should be made clear that claimants may include in their Mechanic's Liens any amount due for labor, services, equipment or materials furnished based upon a written modification of the contract or as a result of the rescission, abandonment or breach of the contract.

6. No. 20 "Payment Bond": The way I read that section is that with regard to charges incurred before the payment bond, the claimant would retain lien and stop notice rights and for charges after the recording of the bond, the claimant would retain bond rights. Quite often on private works of improvement, claimants are not aware of the fact that a payment has been recorded. A provision should be inserted to the effect that a cause of action on the payment bond does not accrue until the claimant has been notified that the bond has been recorded and a copy of the payment bond has been sent to the claimant. The claimant's time to sue on the bond would be six months from the time that the claimant actually received notice of the recording of the bond and a copy of the bond.

7. No. 21 "Preliminary Notice": You should insert the word "reputed" before owner. As you know, a substantial amount of case law has developed with regard to service on a "reputed owner". In that connection, I refer you to Section 9.02(b) of California Construction Law, Sixteenth Edition, together with the supplement thereto which describes all the cases that have interpreted Preliminary Notice requirements in California. There is nothing concerning who the Preliminary Notice should be served upon in a landlord/tenant situation. I would suggest adding a statement that "service on the reputed owner or the reputed tenant shall be sufficient in a landlord/tenant situation". There is no ability to serve the Preliminary Notice at the address shown in the prime contract or in any subcontract. Claimants simply do not have the time nor the resources to look up building permits. Further, you have removed the exception to serving the notice within twenty (20) days. Although the current Preliminary Notice section is excessive, I believe No. 21 needs substantial revision. I should also point out that you will receive substantial opposition to this from lenders and contractors by reason of the fact that there is no requirement to serve them with a Preliminary Notice. You will also receive substantial opposition from the labor

unions who, as you know, made substantial amendments to many provisions of the lien law to try to overcome the cases that held that trust fund claims are pre-empted by ERISA.

8. No. 22 "Service of Stop Notice": There is no requirement for the claimant to bond the stop notice. I agree with that position. However, I suspect you will get substantial resistence from the banks. Further, you have eliminated the language in the current statute which provides that no assignment by the borrower to the lender, whether made before or after the filing of the stop notice, shall impair the stop notice right. As you know, there has been substantial case law that has developed around that section which holds, in effect, that once the lender receives the bonded stop notice, it must withhold the funds and cannot use them for any other purpose. That language should remain in the statute.

9. No. 23 "Amount of Claim": See my comments above concerning the Basic Modular Products' case and the fact that amounts due for change orders, abandonment, rescission and breach of contract should remain in the statute. Furthermore, you state that it shall "exclude consequential damages". There is, of course, no definition of what you mean by consequential damages. That should be eliminated or the term "consequential damages" should be defined. You provide for attorney's fees for stop notice and bond claims, but not for mechanic's lien claims. In that regard, see my original report to the Law Revision Commission.

10. No. 24 "Responsibility of General Contractors, Trade Contractors, and Employers": This obligation to defend and indemnify should arise only if the general contractor or trade contractor has been paid.

11. No. 25 "Asserting a Charge": The reference to the work of improvement that is subject to inspection by a public agency should be deleted. As you know, some very confusing case law has developed concerning that exception. The exception is unnecessary. With regard to a claimant not asserting a charge until it has "finished", I would suggest that that be modified to provide "finished or ceased" in accordance with Civil Code §§3115 and 3116. What about condominium projects? See Section 3131 and the recent case throwing out a lien where the general contractor refused to segregate its claim among the condominium units. Further, the time frame for cessation of labor should be consistent with the current statute, to-wit, sixty (60) days rather than thirty (30) days.

12. No. 26 "Notice of Completion": You should add a provision stating that the name of the contractor should be in the Notice of Completion and it should be executed by the owner.

13. No. 27 "Notice of Cessation": It should provide that the Notice of Cessation should be executed by the owner and the name of the contractor should be inserted.

14. No. 28 "Foreclosure, Arbitration": As you know, under current law, there is an opportunity for the owner and the claimant to agree to an extension of time to foreclose. That often avoids litigation where the parties are negotiating for a settlement and/or going to pay in a short period of time. That should remain in the statute. Likewise, the time for suit on the stop notice should be as is currently set forth in the statute, that is, no later than ninety (90) days after the expiration of the period of time for filing liens.

15. No. 29 "Priority of Mechanic's Liens": The last sentence changes existing case law. It should be deleted.

16. No. 31 "Site Improvement Lien Claims": Quite often, the claimants, whether they be prime contractors, subcontractors, or material suppliers, are unable to make a equitable division in the charge. It should provide that the claimant shall, if able, make an equitable division and if the claimant is unable to do so, then the court can make the equitable division based upon the evidence at the time of trial.

17. No. 32 "Improvements Procured by Tenant": The section you have proposed is ambiguous. What is meant by "required, paid for or otherwise procured"? Why isn't the owner required to post and record a Notice of Non-Responsibility as is currently the law"? Furthermore, the existing statute and case law adequately cover this area and should not be changed.

18. No. 33 "Release Bond": The section should be consistent with current law which states that the claimant is not obligated to bring an action on release bond until it has been served with a copy of the release bond and then has six (6) months to bring the action. It should provide for a release bond both as to a stop notice and a mechanic's lien. As you know, one of these days we are going to run into the problem of a release bond being furnished either with respect to a mechanic's lien or a stop notice and the surety then becoming insolvent thereby depriving the claimant of its constitutional right of lien. If we are going to allow release bonds to continue to be

used then the statute should provide that it can only be furnished by a surety admitted in the state of California with the Bests' rating of AAA,

There are other problems with regard to this rather short form of statute. Some of them that come to mind are as follows:

1. Labor: As you now, there were many amendments made to revise the lien law by trust funds last year. To the extent that those provisions don't remain in the statute, you will get opposition from labor to this shortened form of statute.

2. I am not sure whether you did or did not intend to cover public works. My assumption is that you did not intend to cover public works in this first draft. If my assumption is incorrect, then some legislation regarding public works claims needs to be drafted.

3. I agree that the prompt payment legislation should not be in the mechanic's lien law. A separate statute will have to be drafted and submitted under the appropriate statute.

4. Nothing is mentioned concerning the right of the claimant to record a lis pendens. See Civil Code §3146.

5. What about consolidation and joinder of lien, stop notice and bond claims?

6. What about the ability of the owner to petition to release a lien that has not been foreclosed? See Civil Code §3154.

7. What about over-withholding? That is, the prime contractor's claim includes claim from subs and suppliers and the subs' claims include claims by their suppliers and so forth down the line. This question of duplication should be addressed.

8. What about the duty of the lender to withhold upon receipt of the stop notice? What about giving the right to file a stop notice with the owner where the project is owner financed as distinguished from a construction loan?

9. What if the sureties on the payment bond or release bond become insolvent? See my comments above regarding a requirement that any such bond be issued by a surety licensed to do business in California and have a Best's rating of AAA.

10. What about mistakes or errors not invalidating the lien under Civil Code §3261?

As you can tell by my comments, I think the current draft of the statute is too limited and too short and doesn't cover all the issues. In the quick review that I gave the draft, I may not have covered all of the problems and reserve the right to do so. Perhaps you will want to do a revised draft in light of the above comments and we can continue to attempt to end up with a shorter statute that would be satisfactory to all members of the construction industry.

Very truly yours,

HUNT, ORTMANN, BLASCO,
PALFFY & ROSSELL

Gordon Hunt

GH:slg

CC: Stan Ulrich (via facsimile)
Sam Abdulaziz (via facsimile)

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