Study H-820 September 11, 2001

Memorandum 2001-70

Mechanic's Liens: Double Payment Issue (Draft Tentative Recommendation)

Attached to this memorandum is a staff draft of a tentative recommendation on *The Double Payment Problem in Home Improvement Contracts*. This draft implements decisions made at the June meeting and includes a more detailed explanatory text and some additional provisions intended to improve the proposal. More detail has been added concerning the type and timing of notices from subcontractors and suppliers that may be used to put the owner on notice and prevent good-faith payments to the prime contractor.

Also attached are letters received since the last meeting that relate to the double payment issue:

The first two letters suggest the need for reform of the statute. The third letter condemns the mandatory bonding proposal and requests a different kind of relief.

Keith Honda raises some concerns about the setting of the floor at $10,000 for the mandatory bonding rule and what protections apply below the floor. As to the latter question, the draft proposal protects homeowners' good faith payments to prime contractors regardless of whether there is a bond, thereby protecting those below the floor.

If the Commission approves the tentative recommendation, the staff will distribute it for comment, subject to any revisions to implement Commission decisions, so that comments can be reviewed and a final recommendation prepared in time for the projected January 15, 2002, deadline.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

Att: Stan Ulrich
4000 Middlefield Rd. Room D-1
Palo Alto, CA 94303-4739

Law Revision Commission
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Mr. Ulrich,

Although I've never had a mechanic's lien recorded on my home, the effort to protect myself is an experience worth noting. First of all I'm a licensed realtor so I have some knowledge of how lien's work and how much trouble they can cause a homeowner.

I asked that my contractor supply me with a letter, signed by each individual subcontractor and laborer, explaining that they were paid in full. (That request by the way was rejected by the first two contractors I wanted to hire because they told me it was literally impossible to do. They were right.) As each job was being completed the contractor, who was not here 100% of the time, gave me the letters to get signed. "This is not my job", I thought, isn't that what I'm paying him for? Well it was an unrealistic request and the contractor decided to sign a letter for me saying that all the subcontractors were paid in full. After doing some research, I realized that this type letter is not sufficient protection as a sub may get paid but they may not pay the supplier or the laborers. The job went fairly smoothly, however, but the "letter business" was a confusing and often futile issue as the workers didn't want to sign anything they couldn't read, the sub that arrived was actually an employee and wouldn't sign the letter without his employer's permission, and all of them were quite angry that I would ask for such a letter in the first place. Didn't I trust them? Also, why sign a letter before being paid and why sign after you receive the check.

Of course, right after each job was completed, I received form letter's from the sub contractor's informing me that if they were not ultimately paid, a lien would be placed on my home and I was responsible as per California law. After they received their checks from my contractor, I had to call each and every one of them to get release letters proving payment. They all felt this was a hassle and eventually sent me a letter saying they were paid.

This is not business. I was being held hostage and no matter what precautions I took, I could not get the protection I needed. The contractor needs to hold a higher responsibility, as per California law, since he receives the checks and from there, the subs need to take the responsibility once paid, the suppliers and laborers etc. What am I? A bank, an insurance company? The system needs work.

I will not do my second phase remodel. I can live with what I've got. I can't live with what I've got to go through.

Marc Miller
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M. Miller

EX 1

VIPLEX INDUSTRIES
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541-317-8781 - phn 541-330-0759 - fax

6/30/01

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

Dear Mr. Ulrich:

I wanted to let you know how unfair and outdated the California Mechanics Lien Law is. As with all business, before extending your commodities or services, credit and references checks must be done. Businesses have at their disposal many means to verify this information, such as access to credit bureau's and D & B's. They have the ability to ask for credit, trade and bank references and monitor account balances and terms. Contractors can be required to sign personal guarantees, as well as pledging their business assets. In all other businesses, a credit risk is taken when allowing vendors to purchase on credit. This is an acceptable and necessary risk to being in business; to burden the consumer with this responsibility, and in particular vendors and subcontractors they have never met, is unjust and unreasonable.

Please assist the homeowners in the state of California and reform this century old law. Homeowners who pay their bills in good faith should not be responsible for the negligence of some contractors.

Sincerely,

Susan Jepsen
President Viplex Industries, Inc
California Contractors License # 580718

Cc: The League of California Homeowners
Attention: Ken Willis
99 C Street, Suite 209
Upland, Ca 91786

THE IRVINE COMPANY

James L. Stiepan
Vice President and
General Counsel
Office Properties

July 26, 2001

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

Re: Mechanic's Lien Revisions

Dear Mr. Ulrich:

Having written to you at the beginning stages of your Commission's evaluation, I have since been watching from the sidelines the various axes being ground. Although it would have been difficult to imagine a more intellectually bankrupt statutory regimen than currently exists in the mechanic's lien area, the Commission may be well on its way to achieving that remarkable milestone.

I refer to the proposal regarding mandatory bonding, a proposal that should have died an immediate and inglorious death months ago. While I have little doubt that a feasible bonding scheme can be fashioned given the ingenuities of private enterprise, the appropriate question is whether it behooves our Legislature to require such a scheme. Since forced bonding would result in an across-the-board increase in the cost of all home improvement work just to avoid an untoward result in a comparative handful of cases, then speaking as a California resident and homeowner, the answer is clearly no. Unfortunately, this is an idea that only our government at its most paternal could love, which I suppose makes it a fait accompli.

With your next update, please forward a pack of Rolaids.

Sincerely,

James Stiepan
Vice President and General Counsel
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EX 3

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☞ **Staff Note.** Commentary received from Keith Honda by email, Sept. 11, 2001

Mechanic's Lien Comments

Keith Honda

The impact of the dollar limit on bonds: Does the higher $10k limit provide improved protection for all homeowners? We remained concerned that it does not.

The issue is whether a $5k or higher ($10k) limit provides improved protection for homeowners. Based on the content of the discussion of the Commission members at the June 29th meeting, the Commissioners appeared to support a higher limit because it provided improved protection for homeowners. Based on this apparent reasoning, the Commission increased the recommended limit from $5k to $10k.

In response to a concern that I raised regarding the higher limit, the Commissioners indicated that a higher limit, meant that more transactions would receive a higher level of protection. It is not clear that this is the case.

Though I may have missed it, I have been unable to identify a provision eliminating mechanics' liens for transactions under $10k (where there was no privity). In the absence of a provision eliminating mechanics' liens below the $10k limit, I remain concerned that homeowners will continue to be victimized under the $10k limit. The cost of roofing a smaller home under 1,500 square feet is well under $10k.

In 2000, I authored a report that concluded that the best protection for homeowners was an alternative source of payment for unpaid lien claimants. The June 2001 Draft Tentative Proposal is consistent with that report to the extent that it provides an alternative source of payment: the payment bond.

Section 3244 of the Draft Tentative Recommendation dated June 19, 2001 states that whether or not a payment bond is recorded the liability of a homeowner shall be limited to the contract price. Therefore mechanics' liens would only apply to the extent that the homeowner has not paid the prime contractor in good faith. This is a major improvement over current law.

However, it is not clear that homeowners involved in transactions under $10k have the same protection of those homeowners involved in transactions over $10k. If the transaction exceeds $10k, the bond provides an alternative (to the homeowners) source of payment for unpaid lien claimants. No such protection is provided for homeowners involved in transactions under $10k (though they shall not be liable for more than the contract price).

Though mechanic's liens will not be enforced at this level (because it is too costly), homes will be liened and pressure will be put on homeowners to pay. As is pointed out in the staff report (at page 6)homeowners are threatened with the loss of their homes and very often they agree to pay. This victimization is at the heart of our call for reforms in this area.

Since a small lien claim was the genesis of then-Assemblymember Honda's work in this area, we ask the Commission to provide greater protection to

homeowners in transactions under $10k. The limit to the contract price is an improvement. However, the fact that liens will not actually be enforced gives little comfort in light of what we know about the harassment that often accompanies an unpaid lien claim. It appears that in these smaller transactions homeowners may continue to be subject to double payment -- this results in a lesser level of protection for those transactions under $10k.

To address this concern, we ask that the Commission consider provisions which provide the same level of protection for homeowners both over and under the $10k limit. One option is to eliminate mechanic's lien for transactions under $10k where there is no privity. Though we would support other options (joint checks, mini-direct payment, blanket bond) these appear to be too cumbersome when compared to the (under $10k) problem. If the elimination of the liens approach (except in cases in privity is unacceptable), we urge the Commission to return to the $5k limit originally proposed by in the June 19, 2001 staff report.

THE DOUBLE PAYMENT PROBLEM IN HOME IMPROVEMENT CONTRACTS

THE PROBLEM

Introduction

This tentative recommendation addresses the double payment risk faced by consumers under home improvement contracts.[1] The double payment problem arises because, even though the owner has paid the prime contractor according to the terms of the contract, subcontractors and material suppliers are entitled to enforce mechanic's lien rights against the owner's property if they are not paid by the prime contractor.[2] The homeowner who pays a second time for the materials or the services of subcontractors has a justifiable grievance. But the homeowner is not the only victim in this situation, since the subcontractors and supplier have also not been paid and understandably will seek payment from the homeowner through enforcement of mechanic's liens.

Cautious homeowners, who take the time to learn the law and the available options, and are willing to spend money on additional protections such as joint control or bonding, can avoid the double payment problem. But not many homeowners take these extraordinary steps. Because subcontractors and suppliers have the mechanic's lien right permitting them to pursue payment even from homeowners who have fully paid the prime contractor, they have less incentive to follow standard business practices, much less take any special steps to protect their right to payment from the prime contractor.

Analyzed from a theoretical perspective, the mechanic's lien law is unfairly balanced against the average consumer. It is natural for the homeowner to rely on his or her relationship with the prime contractor and to have confidence that payments under a home improvement contract are directed to the subcontractors,

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1. This tentative recommendation is submitted as part of the Commission's fulfillment of a request from the Assembly Judiciary Committee to undertake a "comprehensive review of [mechanic's lien] law, making suggestions for possible areas of reform and aiding the review of such proposals in future legislative sessions." See Letter from Assembly Members Sheila James Kuehl (Chair) and Rod Pacheco (Vice Chair), June 28, 1999 (attached to Commission Staff Memorandum 99-85). The Commission has long-standing authority from the Legislature to study mechanic's liens under its general authority to consider creditors' remedies, including liens, foreclosures, and enforcement of judgments, and its general authority to consider the law relating to real property. For the text of the most recent legislative authorization, see 2001 Cal. Stat. res. ch. 78.

The great majority of the Commission's study of mechanic's liens has been consumed by the currently hot topic addressed in this recommendation. However, the Commission also plans to submit proposed general revisions of the mechanic's lien law. The general revision proposals will necessarily overlap with sections included in this recommendation, but the Commission believes the two initiatives can be coordinated if legislation is introduced in the 2002 legislative year.

The Commission also plans to prepare a third report providing broader background on the alternatives to this proposal on the double payment problem that the Commission reviewed but did not recommend.

2. See Civ. Code § 3123. A subcontractor may also be the defaulting party, failing to pay lower tier subcontractors and suppliers.

material and equipment suppliers, and laborers who have contributed to the project in full satisfaction of the owner's obligations. If the prime contractor or a higher tier subcontractor does not pay subcontractors and suppliers, the homeowner won't find out about it until it is too late to avoid some double payment liability and perhaps an incomplete project.

The double payment problem may be viewed as a question of who will bear the risk of nonpayment by the prime contractor (or by a subcontractor higher in the payment chain) where the owner has made full payment, and which parties are in the best position to be knowledgeable about the risks and remedies and take appropriate steps. Under the existing scheme, homeowners assume all of the risk associated with the failure of prime contractors to pay subcontractors and suppliers.

Significance of Problem

The significance of this double payment problem is a matter of serious disagreement and the Commission does not have comprehensive statistics indicating the magnitude of the problem. Communications to the Commission suggest that actual mechanic's lien foreclosures are fairly rare. Assembly Member Mike Honda's office identified 61 cases occurring over a three-year period, pulling information from a variety of sources.[3] Anecdotal evidence has been presented to the Commission from individual homeowners as well as from the Contractors' State License Board, although the Board does not necessarily receive reports of double payment and does not collect statistics in this category. In short, there is currently no good measure of the magnitude of the double payment problem.

Several commentators have suggested that the double payment problem occurs so infrequently that it does not justify any major revisions in the mechanic's lien statutes.[4] Some have suggested approaching the issue as one of educating the home improvement consumer so that he or she will know how to make sure subcontractors and suppliers are paid. Others believe that the problem is serious enough, particularly for the homeowners who are forced to pay twice, that some legislative response is called for.

COMMISSION'S TENTATIVE PROPOSAL

After a lengthy study of these issues, consideration of several alternatives, and a review of comments and criticisms of eminent experts and stakeholders,[5] the

3. See Commission Staff Memorandum 2000-9, p. 2.

4. See, e.g., Hunt, *Report to Law Revision Commission Regarding Recommendations for Changes to the Mechanic's Lien Law* [Part 2] (February 2000) (attached to Commission Staff Memorandum 2000-9).

5. The Commission has been ably assisted by its consultants James Acret, Keith Honda, and Gordon Hunt who have prepared written materials and attended many Commission meetings. Mr. Hunt prepared written reports in the early stages of the project, bearing on the double payment issue as well as general reforms. See, e.g., Hunt, *Report to Law Revision Commission Regarding Recommendations for Changes to*

Commission is proposing amendments of the mechanic's lien statute to provide special rules applicable to home improvement contracts, with the following features:

(1) The proposed law would apply to all home improvement contracts, as defined under the Contractor's State License Law.

(2) An owner who pays the prime contractor in good faith would not be subject to further liability.

(3) Mechanic's liens and stop notices would apply only to the extent that the owner had not paid the prime contractor in good faith.

(4) A surety bond in the amount of 50% of the contract price would be required in all home improvement contracts over $10,000.

(5) The bond would be obtained by the prime contractor, and would be recorded with the county recorder, along with a filed copy of the contract between the owner and prime contractor.

(6) Claims of subcontractors and suppliers would be made against the bond or other liable parties, but could not be made against the owner to the extent the owner has paid the prime contractor in good faith.

(7) Stop notice rights of all claimants would continue. A stop notice or claim of lien served on the owner who has not paid the prime contractor would prevent payment in good faith, but could not be served until payment to the claimant was overdue.

(8) The preliminary 20-day notice would not be required and the restrictions on the rights of subcontractors and suppliers in the existing preliminary notice scheme would not apply.

(9) For home improvement contracts under $10,000, the owner would still be protected by the good faith payment rule, the claimants would not need to give the preliminary notice, and stop payment and mechanic's lien rights would continue to apply.

(10) Subcontractors and suppliers would be responsible for determining whether the bond had been recorded.

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the Mechanic's Lien Law [Part 1] (November 1999) (attached to Commission Staff Memorandum 99-85); *id.* [Part 2] (February 2000) (attached to Commission Staff Memorandum 2000-9) [hereinafter Hunt Report Part 1]; *Report to Law Revision Commission Regarding Current Proposals Pending Before the Commission Regarding Changes to the Mechanic's Lien Law* (August 2000) (attached to First Supplement to Commission Staff Memorandum 2000-63) [hereinafter Hunt Report Part 2]. Mr. Acret and Mr. Honda have also submitted numerous written materials. See, e.g., Commission Staff Memorandums 2000-9 & Second Supplement, 2000-26 & Second Supplement, First Supplement to Memorandum 2000-63, 2000-78. A number of other interested persons, some of them representing stakeholders in the construction world, have provided important assistance to the Commission, including Samuel Abdulaziz, Peter Freeman, Ellen Gallagher (CSLB), Kenneth Grossbart. A complete list of persons attending Commission meetings relating to mechanic's liens can be compiled from the Minutes of the following meetings: November 1999; February, April, June, July, October, and December 2000; February, May, and June 2001. Written commentary can be found in the exhibits to Commission meeting materials, available at the Commission's website at <http://www.clrc.ca.gov>. For all mechanic's liens materials, see <ftp://clrc.ca.gov/pub/Study-H-RealProperty/H820-MechanicsLiens/>.

(11) Any party would be able to contract for additional notices or greater protections, such as with additional bonds or the use of joint control, and the owner could use joint checks to direct payment to subcontractors and suppliers.

(12) The proposed law would be subject to a one-year deferred operative date to enable implementation of regulations and procedures, and education of the affected parties.

These elements are discussed more detail below.

Scope of Special Protections — Home Improvement Contracts

The proposed law would apply to all "home improvement contracts," as defined under the Contractor's State License Law.[6] Home improvement contracts are appropriate for special treatment under the mechanic's lien law because this class of construction contracts have been the focus of special Legislative attention for more than 30 years.[7] Employing other classifications, such as single-family, owner-occupied dwellings, may also be appropriate, but it should be more straightforward to use an existing classification that should be familiar to contractors and suppliers. Since home improvement contracts are required to be executed in a special form, it should be easy for those not in privity with the owner

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6. Home improvement is defined in Business and Professions Code Section 7151:

> 7151. "Home improvement" means the repairing, remodeling, altering, converting, or modernizing of, or adding to, residential property and shall include, but not be limited to, the construction, erection, replacement, or improvement of driveways, swimming pools, including spas and hot tubs, terraces, patios, awnings, storm windows, landscaping, fences, porches, garages, fallout shelters, basements, and other improvements of the structures or land which is adjacent to a dwelling house. "Home improvement" shall also mean the installation of home improvement goods or the furnishing of home improvement services.
>
> For purposes of this chapter, "home improvement goods or services" means goods and services, as defined in Section 1689.5 of the Civil Code, which are bought in connection with the improvement of real property. Such home improvement goods and services include, but are not limited to, carpeting, texture coating, fencing, air conditioning or heating equipment, and termite extermination. Home improvement goods include goods which are to be so affixed to real property as to become a part of real property whether or not severable therefrom.

Home improvement contract is defined in Business and Professions Code Section 7151.2:

> 7151.2. "Home improvement contract" means an agreement, whether oral or written, or contained in one or more documents, between a contractor and an owner or between a contractor and a tenant, regardless of the number of residence or dwelling units contained in the building in which the tenant resides, if the work is to be performed in, to, or upon the residence or dwelling unit of the tenant, for the performance of a home improvement as defined in Section 7151, and includes all labor, services, and materials to be furnished and performed thereunder. "Home improvement contract" also means an agreement, whether oral or written, or contained in one or more documents, between a salesperson, whether or not he or she is a home improvement salesperson, and (a) an owner or (b) a tenant, regardless of the number of residence or dwelling units contained in the building in which the tenant resides, which provides for the sale, installation, or furnishing of home improvement goods or services.

7. See, e.g., 1969 Cal. Stat. ch. 1583 (enacting Bus. & Prof. Code §§ 7151.2, 7159). Special rules, including home improvement certification requirements are set out in Business and Professions Code Sections 7150-7168.

to determine whether the job is subject to special rules in the Contractors' State License Law and in the mechanic's lien law as revised in this proposal.

Protection Against Liability for Double Payment

An owner who pays the prime contractor in good faith would not be subject to further liability. This is the basic protection afforded homeowners[8] under the proposed revisions of the mechanic's lien law. This rule is consistent with the common expectations of people who have not learned of the special rules applicable to mechanic's liens in California since 1911.[9] From the owner's perspective, common sense and fairness dictate that payment to the contractor in good faith under the contract should be the end of the owner's liability.

Accordingly, mechanic's liens and stop notices should apply only to the extent that the owner has not paid the prime contractor in good faith. In general, subcontractors and suppliers (as well as the prime contractor) would continue to have their existing remedies against the property and funds of the owner for amounts that are due but unpaid. If the owner has not paid in good faith, the existing remedies would also be available.

Mandatory Bonding

In order to protect subcontractors and suppliers who would no longer have rights against a good-faith homeowner, the proposed law would require prime contractors to obtain a payment bond, from an admitted surety insurer, in the amount of 50% of the contract price for all home improvement contracts over $10,000. In the interest of efficiency, the bonding requirement may be satisfied by blanket bonds satisfying regulations of the Contractors' State License Board.

The 50% payment bond approach to addressing the double payment issue is grounded in an existing remedy. Civil Code Section 3235, whose core provisions date back to 1911, permits the owner to limit liability to the amount of the contract remaining unpaid by filing the contract and recording a surety bond for 50% of the contract amount, before work commences. The Section 3235 procedure does not appear to have been used often enough to develop much case law or statutory refinements, so many question remain unanswered. Consequently, the proposed law provides a new implementation of the 50% payment bond concept to protect homeowners from double liability and to provide a fund for subcontractors and suppliers working on home improvement projects.

Payment bonds, and other forms of surety bonds, are familiar in the construction industry. Several types of bonding options exist: performance bonds, payment bonds, release bonds, etc. A contractor can get a payment bond to cover payments

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8. "Homeowner" will be used interchangeably with "owner" in this discussion, even though the owner may be a lessor.

9. The historical development of the mechanic's lien law is summarized in "Constitutional Considerations" *infra.*

to subcontractors. Subcontractors can get a bond to guarantee payment to sub-subcontractors and material suppliers. An owner can seek a bond to substitute for the mechanic's lien remedy. But on small projects and in the home improvement area, bonds are generally not a practical option. The cost of a bond can be 1-5%, some contractors may have difficulty qualifying, and human nature is to avoid the trouble and expense of a bond until it is too late.

Mandatory bonding would be a mixed blessing. The advantages of the security provided for potential claimants, the protection against the owner's double liability, and the potential for improving the financial soundness of the home improvement industry, must be weighed against the added cost and burden of obtaining bonds and the difficulty some worthy contractors may have in satisfying bond underwriters.

Advantages and Disadvantages of Payment Bonds

Professor George Lefcoe has written:[10]

> Bonding is needed most when it is least likely to be available. Small and undercapitalized contractors do modest-sized jobs for individual property owners on tight budgets. In these situations, few contractors have the credit necessary to get a bond. The costs of such bonds as are available will be prohibitive to the owner and the contractor.

He believes that the recorded bonded contract option under Civil Code Section 3235 "offers the best protection for the owner, but is the least often used because few owner know about it and, in any event, bonding is a costly and bureaucratic exercise for the novice."[11]

The Nolo Press self-help guide says little about payment bonds, since they are "not a viable option for most small property owners."[12] Of course, under the Commission's proposal, the prime contractor, who should have the necessary knowledge and experience, would obtain the bond, not the homeowner. As to the recorded contract and 50% bond under Section 3235, the Nolo Guide says:[13]

> Although this approach to reducing mechanics lien risk may seem like a good idea, most general contractors will not qualify for a payment bond equal to 50% of the overall project cost.… [In a $100,000 project example] the cost of the bond would be somewhere in the neighborhood of $10,000, which would be economically unfeasible as well. As a general rule, this owner protection is seldom used except on extremely large projects involving highly bondable general contractors and price tags that allow the cost of the bond to be absorbed in the larger project.

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10. G. Lefcoe, *Mechanics Liens*, in Thompson on Real Property § 102.02(a)(2)(i), at 560 (Thomas ed. 1994).

11. *Id.* § 102.02(a)(2)(iv), at 562.

12. S. Elias, Contractors' and Homeowners' Guide to Mechanics' Liens 9/13 (Nolo Press 1998) [hereinafter Nolo Guide].

13. *Id.* at 9/12-9/13.

The Commission is informed that the cost of the proposed 50% payment bonds should be in the range of one-half to 3%.[14] Other estimates range from 1-5% on the bond amount, which would be equivalent to one-half to 2½% of the contract amount. The policy question for ultimate resolution in the legislative process is whether this anticipated expense is justified by the advantages of the mandatory 50% payment bond.

In his report to the Commission, Gordon Hunt analyzed mandatory full payment and performance bonds as follows:[15]

> [A]nother alternative would be to make the furnishing of a payment and a performance bond mandatory in the case of a single-family owner-occupied dwelling that is the primary residence of the owner.… The cost of the bonding, of course, is passed on to the owner and it would increase the cost of the project to the owner, but it would provide the owner with ultimate protection from a defaulting original contractor. It would completely serve to protect the owner from the failure of the original contractor to pay subcontractors, laborers, and suppliers. It would likewise protect the owner from failure to complete by the original contractor. The primary objection to any such statute would be claims by contractors that they would be unable to obtain such bonds because they are not "bondable." Those, of course, are the very contractors that shouldn't be in the home improvement business to begin with. If such a provision were enacted, the marketplace would react and surety companies would be willing to write such bonds and would find ways in the underwriting process to protect their interests. Specifically, sureties would take a more active participation in the projects that they bond for small contractors to insure that the money flows down from the contractor to the subcontractors, laborers, and suppliers. This would increase the cost of the bonds and thus the cost to the owner, but would provide the owner with much greater protection from defaulting original contractors. The cost of the bond would be much less than having to litigate and pay Mechanic's Liens.

The Commission's proposed 50% payment bond is intended as a less-expensive and more efficient alternative to full bonding by way of payment and performance bonds, in recognition of the likelihood that bond costs will be passed on to homeowners and that qualifying for full payment and performance bonds would be significantly more difficult for many contractors than the 50% payment bond.

Duty to Obtain and Record Bond

The prime contractor would have the duty under the proposal to obtain and record the bond. Following the existing scheme, the home improvement contract would be filed (as opposed to recorded) with the county recorder. As a first step, this scheme should work because it is familiar to contractors, subcontractors, suppliers, and lenders, even if it may appear burdensome to someone outside the

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14. Email from Andy Faust, American Contractors Indemnity Co. (June 27, 2001) (attached to Second Supplement to Commission Staff Memorandum 2001-52).

15. Hunt Report Part 2, *supra* note 6, at 10; see also Hunt, *California Mechanics' Lien Law: Need for Improvement*, 9 Santa Clara Law. 101, 107-09 (1968).

construction industry. Further study may lead to cheaper and more efficient substitutes, such as filing with the Contractors' State License Board and providing information on the Internet.

A number of alternatives for contractors who could not be bonded, such as cash deposits or joint control, could be implemented, but the proposal sets out only the 50% payment bond of an admitted surety insurer since it would be less confusing for persons relying on the security of the prime contractor.

Nature of Bond

The best security is a bond issued by an admitted surety insurer. The staff draft adopts this as the standard. The drawback is that surety companies underwrite bonds based on the soundness of the bond principal. The argument is always made against mandatory bonding that it will drive many contractors out of business. On the other hand, bonding is required in public works. It has also been suggested that smaller bonds will be readily available for entry-level general contractors, and that the difficulties will only develop if the contractor is trying to take on too many projects or projects that are too complicated in relation to the contractor's experience.

The proposal also includes an amendment to the home improvement contract form to provide a space for indicating the name and telephone number of the surety on the bond so that owners, subcontractors, suppliers, and lenders can verify the prime contractor's bond status. Education efforts can focus on obtaining and verifying one sound form of security more effectively than offering a smorgasbord of options, each with its own features and verification rules.

Setting the Floor on Mandatory Bonding

Under the Commission's proposal, the mandatory payment bond would not apply to home improvement contracts under $10,000.[16] Any such statutory threshold is somewhat arbitrary, and reflects an estimation of the appropriate level after balancing a number of factors. Since the proposed mandatory bond is in the amount of 50% of the contract price, the threshold may also be viewed as a $5,000 amount for the purposes of assessing efficiency of scale and the need for the protection afforded by the bond security.

A $5,000 minimum bond amount is the same as the limitation on small claims court jurisdiction,[17] which may be taken as one measure of "smaller" contracts where less formal rules are appropriate.

16. If the prime contractor has a blanket payment bond, it would cover all home improvement contracts, not just those over $10,000.

17. Code Civ. Proc. § 116.220.

Taking inflation into account, this amount is also generally in line with a State Bar committee proposal from 40 years ago, which would have set the floor amount for a full mandatory bond at $1,000.[18]

Although some different policies are involved, it is interesting to note that public works are not required to be bonded in California below $25,000.[19]

Enforcement of Claims by Subcontractors and Suppliers

The main purpose of the mandatory bond is to provide a reliable source of payment for claims of subcontractors and suppliers who have not been paid by the prime contractor. The bond thus substitutes for the mechanic's lien and is available to subcontractors and suppliers even where the owner has defaulted. The proposed shield for owners who have paid amounts owing under the contract in good faith does not apply to the extent payments have not been made, and in these cases, subcontractor and suppliers, as well as the prime contractor, would also have their mechanic's lien and stop notice rights as under existing law.

There are several significant differences between enforcement of claims under the proposed law and existing law:

(1) Stop notices and claims of lien that would put the homeowner on notice so as to prevent further good faith payments to the prime contractor could not be given until payment was overdue to the subcontractor or supplier. Under existing law, a claimant who has given a preliminary 20-day notice is free to record a claim of lien after he or she has "ceased furnishing labor, services, equipment, or materials"[20] and does not need to wait until payment is overdue or the job is complete. To permit routine use of stop notices and lien claims as soon as the subcontractor or supplier has finished his or her part of the job would defeat the purpose of the mandatory bond and the ability of homeowners to rely on their contract with the prime contractor.

(2) The preliminary 20-day notice is not required as a prerequisite to lien claims, stop notices, or enforcement against bonds. Since the 50% payment bond is intended as the primary guarantee for payment of claims of subcontractors and suppliers, the preliminary notice would have little purpose and would be a needless expense. The preliminary notice would have no effect in home improvement contracts and would not serve to prevent good faith payments by the homeowner to the prime contractor. Service of the existing notice on a homeowner would only result in confusion.

(3) Where subcontractors and suppliers anticipate that they may not be paid by the prime contractor, they would have the alternative of giving the owner and

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18. See Comment, *The "Forgotten Man" of Mechanics' Lien Laws — The Homeowner*, 16 Hastings L.J. 198 (1964). The $1,000 amount would be over $5,700 today.

19. Civ. Code § 3247.

20. Civ. Code § 3116.

prime contractor a direct pay notice that would call for the owner to pay the subcontractor or supplier directly instead of through the prime contractor when the prime contractor bills for their work or supplies. The direct pay notice could be served for any work or supplies that had been furnished and would not have wait for payment to become overdue.

Procedural Simplification

Under the current statute, subcontractors and suppliers are commonly advised to routinely send out the preliminary 20-day notice as soon as they sign a contract or start work on a job.[21] The preliminary notice relates back for 20 days, even if it is given late, but it is generally a prerequisite to use of other remedies under the mechanic's lien statute, including stop notices and bond recovery.[22]

Under the proposal, the preliminary notice would not be required and the restrictions on the rights of subcontractors and suppliers in the existing preliminary notice scheme would not apply. Although subcontractors and suppliers would not be forbidden to give a preliminary notice to the owner, it would not have any effect and would not serve as notice of nonpayment that would serve to prevent the owner making good-faith payments under the contract with the prime contractor.

Protections Under Small Contracts

Mandating 50% payment bonds, with the associated expense of filing the contract and bond with the county recorder, becomes increasingly inefficient and burdensome for smaller contracts. The risk exposure for the parties is also significantly lower the smaller the overall contract price. Accordingly, the floor applicable to the mandatory bonding for home improvement contracts under the Commission's proposal in the aggregate amount of $10,000. But it is also inefficient to continue the burdensome and premature service of multiple copies of preliminary 20-day notices on owners, prime contractors, and lenders. The proposal dispenses with the need to give preliminary notices in home improvement contracts under $10,000, thereby saving this cost and paper-shuffling burden on the parties.

The owner, however, is still in need of the protection afforded by the good faith payment rule. It is suspected that many of the abuses probably occur in smaller contracts, such as roofing or fencing jobs, where the work can be completed quickly with one delivery of materials. The preliminary notice, with its 20-day relation back feature, does not act as a consumer protection because the owner may not receive any notices until after payments have been made to the prime contractor. Under the proposed law, the owner is protected from double liability for payments made in good faith, even if there is no payment bond.

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21. See S. Abdulaziz, California Construction Law 200-01, 204 (K. Grossbart ed. 2000); Nolo Guide, *supra* note 12, at 1/8, 2/2-2/3.

22. See, e.g., Civ. Code §§ 3097(a), 3114.

Subcontractors and suppliers may still be protected for their work on contracts under $10,000 if there is a blanket payment bond. Of course, their risk exposure is comparatively smaller, as well, because they are risking a portion of a smaller contract. Subcontractors and suppliers would be able to assess their risk exposure by determining if there is a blanket payment bond and using standard business practices to evaluate the creditworthiness of their customer, the prime contractor or higher-tier subcontractor. They would continue to have their mechanic's lien and stop notice rights, but without the necessity or limitations of the preliminary notice regime — subject to the limitation that they would not be entitled to a mechanic's lien on the homeowner's property to the extent that the contract had been paid in good faith.

Protecting homeowners under small contracts serves the fundamental purpose of providing a meaningful degree of consumer protection without dazingly complicated forms and deadlines. It also recognizes that subcontractors and suppliers will rarely pursue the mechanic's lien remedy under existing law for smaller amounts because of the costs involved. The Commission is informed that the lack of recoverable attorney's fees in mechanic's lien foreclosure makes it impractical for subcontractor or supplier to pursue amounts under $5,000 or $8,000 (depending on the assessment of the particular business). In most cases, an individual subcontractor or supplier's portion of a home improvement contract under $10,000 would likely fall in the range of unforeclosable liabilities.

Market Principles

A major defect that has been identified in the existing system is reliance on the homeowner to sort through the various notices and correctly anticipate the best remedy. As a general rule, homeowners are likely to initiate few home improvement projects in a lifetime, whereas contractors and suppliers have daily experience in the business. This principle lies at the heart of consumer protection. Of course, there may also be significant inequalities in business and legal sophistication, bargaining power, financial soundness, and risk aversion among prime contractors, subcontractors, and suppliers. But as a class, those in the construction business and trades should be expected to have greater knowledge and sophistication about how things work than homeowners as a class.

Accordingly, it is appropriate to rely on those in the construction business to take minimal steps to protect their interests, particularly where it is much easier and cheaper for them than for homeowners. For example, it is much easier for a prime contractor to obtain a payment bond than it would be for a homeowner. Subcontractors and suppliers are in a better position to determine whether joint control is needed and to find a joint control company to perform the function. The only traditional "remedy" homeowners might readily understand is the use of joint checks, but this has not proven to be an adequate remedy.

Under the proposal, subcontractors and suppliers would be responsible for determining whether an individual bond had been recorded on the contract or

whether a blanket payment bond is in force. Subcontractors and suppliers are the direct beneficiaries of the payment bond and should be familiar with the technicalities of obtaining information from county recorders, surety companies, and the Contractors' State License Board. In the absence of a bond, their risk exposure increases, so it makes business sense to know before entering a contract or extending credit, by performing work or supplying equipment or materials, whether the payment bond is in place.

Deferred Operative Date

The proposed law would be subject to a one-year deferred operative date to enable implementation of regulations and procedures by the Contractors' State License Board, the revision of forms, and the education of the affected parties.

CONSTITUTIONAL CONSIDERATIONS

Article XIV, Section 3, of the California Constitution provides:

> Mechanics, persons furnishing materials, artisans, and laborers of every class, shall have a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished; and the Legislature shall provide, by law, for the speedy and efficient enforcement of such liens.[23]

Any statute that qualifies or imposes conditions on this important right must pass constitutional muster.

Background and History

The history of the mechanic's lien law in California is relevant to an understanding of the dimension of permissible legislation and the context of the law as understood by the framers of the 1879 California Constitution.

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23. This is the language as revised in 1976, which is identical to the original 1879 provision in Article XX, Section 15, except that "persons furnishing materials" was substituted for the original "materialmen" by an amendment in 1974. Note that the beneficiaries of the constitutional lien differ from the statutory implementation in Civil Code Section 3110 (the constitutional classes are in bold):

> **Mechanics**, **materialmen**, contractors, subcontractors, lessors of equipment, **artisans**, architects, registered engineers, licensed land surveyors, machinists, builders, teamsters, and draymen, and all persons and **laborers of every class** performing labor upon or bestowing skill or other necessary services on, or furnishing materials or leasing equipment to be used or consumed in or furnishing appliances, teams, or power contributing to a work of improvement ….

Literally, only material suppliers and persons performing three classes of labor are covered by the constitutional language. An early treatise summarized the different classes of workers as follows: The man who constructs anything by mere routine and rule is a mechanic. The man whose work involves thought, skill, and constructive power is an artificer. The hod-carrier is a laborer; the bricklayer is a mechanic; the master mason is an artificer.…" Treatise on the Law of Mechanics' Liens and Building Contracts § 110, at 102 n.8 (S. Bloom ed. 1910). Currently, the statutes do not define "mechanic" or "artisan," but "laborer" is defined in Civil Code Section 3089(a) as "any person who, acting as an employee, performs labor upon or bestows skill or other necessary services on any work of improvement."

The mechanic's lien statutes date back to the first Legislature, which enacted a rudimentary mechanic's lien statute on April 12, 1850 — five days before defining property rights of spouses.[24] The first mechanic's lien case reached the Supreme Court that same year, when the court ruled that a lumber merchant did not have a lien on the building under the mechanic's lien statute where he had failed to comply with the 60-day recording period following completion of construction.[25]

The double payment problem appeared in the cases within the first decade. In *Knowles v. Joost*[26] the Supreme Court ruled that, under the statute, an owner who had paid the contractor in full was not liable to materialmen.[27]

In *McAlpin v. Duncan*[28] the court again addressed the double payment problem, this time under the 1858 statute:

> The question presented by the record is, whether the defendant, having paid the contractor in full before notice of the claims of these parties, can be compelled to pay a second time.…
>
> [The 1858 statute] is not a little confused and difficult of satisfactory construction. If it were designed to give to the sub-contractor and laborer a lien upon the property of the owner for the entire amount of the last or sub-contract, without any regard to the amount of the principal contract, a very curious anomaly would exist, and the whole property of the owner might be placed at the discretion of the contractor, to be encumbered by him as he chose. Such laws, as we have held in this very class of cases, are to be strictly construed, as derogating from the common law.…
>
> We think all that can be gathered from this act, is that material-men, sub-contractors, etc., have a lien upon the property described in the act to the extent (if so much is necessary) of the contract price of the principal contractor; that these persons must give notice of their claims to the owner, or the mere existence of such claims will not prevent the owner from paying the contractor, and thereby discharging himself from the debt; that by giving notice, the owner becomes liable to pay the sub-contractor, etc. (as on garnishment or assignment, etc.), *but that if the owner pays according to his contract, in ignorance of such claims, the payment is good*.

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24. Compiled Laws ch. 155. Section 1 granted a lien to "master builders, mechanics, lumber merchants, and all other persons performing labor or furnishing materials" in constructing any building or wharf. Section 2 provided a notice procedure whereby any "sub-contractor, journeyman, or laborer" could, in effect, garnish payments from the owner. Section 3 provided for recording and commencement of an action "to enforce his lien."

25. Walker v. Hauss-Hijo, 1 Cal. 183 (1850).

26. 13 Cal. 620 (1859).

27. "It was not the design of the Legislature to make him responsible, except upon notice, or to a greater extent, than the sum due to the contractor at the date of the notice." *Id.* at 621. The first reported reference to the problem came in Cahoon v. Levy, 6 Cal. 295, 296-97 (1856):

> If they are to be allowed sixty days after the completion of the building to serve such notice on the owner, it will not unfrequently occur that he will be subjected to pay the same amount twice; as it will be impossible for him to ascertain the claims against the principal contractor, and his agreement with him may be for payment by instalments, or on the completion of the work.

28. 16 Cal. 126 (1860).

> Unless this view is correct, the grossest absurdities appear. We have, in the first place, a valid contract, with nothing appearing against it, which yet cannot be enforced — a clear right of action on the part of the contractor, with no defense by the defendant, and yet which cannot be enforced; *or* which the plaintiff may enforce at law, and yet, if the defendant pays the money, with or without suit, he must pay it again. Innumerable liens may be created, without the knowledge of the owner, for which he might be held liable; while the owner could never pay anything until after long delays, whatever the terms of the contract, or the contractor's necessity for money, unless payment were made at the expense, or at the risk of the payor. Such a construction would lead to law suits and difficulties innumerable. By the other construction, no injustice is done or confusion wrought. These sub-contractors, etc., have only to notify their claims to the owner, in order to secure them. *If they, by their own laches, suffer the owner to pay over the money according to the terms of his contract, they ought not to complain; for it was by their own neglect of a very simple duty that the loss accrued; and it would be unjust to make the owner pay a second time because of that neglect.*[29]

Of course, cases such as *McAlpin* were decided before mechanic's liens were addressed in the constitution, but *McAlpin* touches on several themes that remain relevant 140 years later. The court was faced with a "confused" and "difficult" statute, and balanced the interests of the parties by placing responsibility where it logically lay, in order to avoid the injustice of double payment.

These cases were the beginning of a long line of consistent rulings, even though the statute changed in its details from time to time. Thus, in *Renton v. Conley*[30] the court ruled under the 1868 statute, as it had under the 1856 and 1858 statues, that

> notwithstanding the broad language of the statute, … where the owner had made payments to the contractor in good faith, under and in pursuance of the contract, before receiving notice, either actual or constructive, of the liens, the material men and laborers could not charge the buildings with liens, exceeding the balance of the contract price remaining unpaid when notice of the lien was given.

The first codification of the mechanic's lien statute in the 1872 Code of Civil Procedure included, in Section 1183, a provision that "the aggregate amount of such liens must not exceed the amount which the owner would otherwise liable to pay." But the code revisions of 1873-74 restored much of the language of the 1868 act, including the provision making contractors and subcontractors agents of the owner, and omitted the limitation on the aggregate amount of liens.

Nevertheless, the line of contract-based cases continued through the period of the Constitutional Convention in 1878-79 and thereafter, up until the "direct lien" revision in 1911 (with a brief detour through an 1880 amendment). This case law was reflected in the constitutional debates. In 1885 the statute was amended to reflect the basic contract analysis of the cases, with some creative rules applicable where the contract was void or not completed. The strict limitations imposed by

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29. *Id.* at 127-28 [emphasis added].

30. 49 Cal. 185, 188 (1874).

the courts through the contract analysis resulted in hardship to subcontractors, suppliers, and laborers employed by the contractor where there were no payments were due because the contract was void or where the contractor abandoned the project. Under the cases during this era, only the amount remaining due and unpaid was available for claims of subcontractors, suppliers, and laborers not in privity with the owner.[31]

In 1885, however, the situation of the void contract was addressed, giving the claimants under the original contractor a direct lien for the value of their work, not limited by the contract amount.[32] Reflecting the perspective of 100 years ago, Counselor James in his treatise analyzed this rule as follows:

> The effect of section 1200 is, in all cases coming within its provisions, to charge the property of the owner with liens of persons other than the owner to the extent in value of the work actually done or of the materials actually furnished by them measured always by the standard of the contract price. If the effect was to *charge the property of the owner with such liens beyond the limit of the contract price, it would according to all of the authorities, be unconstitutional*.[33]

Clearly it was the expectation at the time, shortly after adoption of the constitutional mechanic's lien provision, that the mechanic's lien right was subject to overriding contract principles.

The 1885 amendments did not change the fundamental rule existing from the earliest years that protected a good-faith owner from liability for double payment where payments had already been made under the contract with the original contractor. Payment of any part of the contract price before commencement of the project was forbidden and at least 25% of the contract price was required to be withheld until at least 35 days after final completion. Code of Civil Procedure Section 1184 was revised to impose a duty on the owner to withhold "sufficient money" due the contractor to pay the claim of other lien claimants who gave notice to the owner. The amendments also required payment in money (later held unconstitutional), mandated written contracts for jobs over $1000, and provided for allowances for attorney's fees of claimants (later held unconstitutional).

End of the Contract Era

The dominance of the law of contract — which had survived repeated legislative adjustments in the 1850s through 1880, the Constitutional Convention of 1878-79, and the more significant legislative revisions in 1885 and after — came to an end

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31. See, e.g., *Dingley v. Greene*, 54 Cal. 333, 336 (1880) ("if there is no existing lien on the original contract, none exists on the subsidiary contract"); *Wiggins v. Bridge*, 70 Cal. 437, 11 P. 754 (1886); F. James, The Law of Mechanics' Liens upon Real Property in the State of California §§ 80-81, at 83-85 (1900, Supp. 1902).

32. See 1885 Cal. Stat. ch. 152, §§ 1, 2.

33. James, *supra* note 31, § 310, at 329.

with the revision of 1911.[34] Code of Civil Procedure Section 1183 was amended to adopt the "direct lien" approach: "The liens in this chapter provided for shall be direct liens, and shall not in the case of any claimants, other than the contractor be limited, as to amount, by any contract price agreed upon between the contractor and the owner except as hereinafter provided.…"[35] The pre-1911 limitation on the liability of the owner to amounts remaining due under the contract was now only available through obtaining a payment bond in the amount of 50% of the contract price. In general terms, the current statute is a direct descendent of the 1911 revisions.

The leading case of *Roystone Co. v. Darling*[36] gives a useful overview of the 1911 revision and the reasons for it, and places the statutory history in context with the case law. *Roystone* also is significant for the fact that it reflects a broad view of legislative power to implement the constitutional mandate:

> [The 1911 statutory] revision made some radical changes in the law, and it presents new questions for decision. It will aid in the understanding of the purpose and meaning of this act if we call to mind, as briefly as may be, the history of the mechanic's lien laws in this state and the state of the law on the subject at the time the amendments in question were enacted.
>
> Prior to the adoption of the constitution of 1879 the lien of mechanics and materialmen for work done and materials furnished in the erection of buildings was entirely a creature of the legislature. The former constitution contained no declaration on the subject. Numerous decisions of the supreme court had declared that all such liens were limited by the contract between the owner and the contractor, and could not, in the aggregate, exceed the contract price. The doctrine that the right of contract could not be invaded by legislative acts purporting to give liens beyond the price fixed in the contract between the owner and the contractor, or regardless of the fact that the price had been wholly or partially paid, was so thoroughly established that litigation involving it had virtually ended. Section 1183 of the code, as amended in 1874, declared that every person performing labor or furnishing materials to be used in the construction of any building should have a lien upon the same for such work or material. It did not limit the liens to the contract price. In this condition of the law the constitution of 1879 was adopted.…
>
> ….
>
> In 1880 section 1183 was again amended by inserting a direct declaration that "the lien shall not be affected by the fact that no money is due, or to become due, on any contract made by the owner with any other party." This amendment of 1880 first came before the supreme court for consideration in *Latson v. Nelson*, [2 Cal. Unrep. 199], … a case not officially reported. The court in that case considered the power of the legislature to disregard the contract of the owner with the contractor and give the laborer or materialman a lien for an amount in excess

34. 1911 Cal. Stat. ch. 678.

35. The rule in former Code of Civil Procedure Section 1183 is continued in Civil Code Section 3123, which also refers to "direct liens."

36. 171 Cal. 526, 530-34, 154 P. 15 (1915).

of the money due thereon from the owner to the contractor. In effect, it declared that section 15, article XX, of the constitution was not intended to impair the right to contract respecting property guaranteed by section 1, article I, thereof, and that the provisions of the code purporting to give a lien upon property in favor of third persons, in disregard of and exceeding the obligations of the owner concerning that property, was an invalid restriction of the liberty of contract.… In the meantime the legislature of 1885 …, apparently recognizing and conceding the force of the decision in *Latson v. Nelson*, undertook to secure and enforce the constitutional lien by other means, that is, by regulating the mode of making and executing contracts, rather than by disregarding the right of contract. It amended sections 1183 and 1184 of the code by providing that in all building contracts the contract price should be payable in installments at specified times after the beginning of the work, that at least one-fourth thereof should be made payable not less than thirty-five days after the completion of the work contracted for, that all such contracts exceeding one thousand dollars should be in writing, subscribed by the parties thereto, and should be filed in the office of the county recorder before the work was begun thereunder, that if these regulations were followed, liens upon the property for the erection of the structure should be confined to the unpaid portion of the contract price, but that all contracts which did not conform thereto, or which were not filed as provided, should be void, that in such case the contractor should be deemed the agent of the owner, and the property should be subject to a lien in favor of any person performing labor or furnishing material to the contractor upon the building for the value of such labor or material. This law, with some amendments not material to our discussion, remained in force until the enactment of the revision of 1911 aforesaid.

In the meantime the supreme court has followed the rule established by the cases … and has uniformly declared, with respect to such liens, that if there is a valid contract, the contract price measures the limit of the amount of liens which can be acquired against the property by laborers and materialmen. [Citations omitted.]… In addition to these express declarations there are many cases in which the rights of the parties were adjudicated upon the assumption that this proposition constituted the law of the state. Each one of the large number of decisions regarding the priorities of liens in the unpaid portion of the contract price, each decision respecting the right to reach payments made before maturity under such contract, each decision as to the formal requisites of contracts under the amendment of 1885, and each decision as to the apportionment under section 1200 of the Code of Civil Procedure, upon the failure of the contractor to complete the work, constitutes an affirmance of the doctrine that the contract, legally made, limits the liability of the owner to lien claimants. There has been scarcely a session of this court since the enactment of that amendment at which one or more cases have not been presented and decided which, in effect, amounted to a repetition of this doctrine.…

….

We have shown that when [the 1911] act was passed it was the established doctrine of this state that the legislature cannot create mechanics' liens against real property in excess of the contract price, where there is a valid contract, but that it is within the legislative power, in order to protect and enforce the liens provided for in the constitution, and so far as for that purpose may be necessary, to make reasonable regulations of the mode of contracting, and even of the terms

> of such contracts, and to declare that contracts shall be void if they do not conform to such regulations.…
>
> The portions of the act of 1911 above quoted clearly show that the legislature did not intend thereby to depart from this doctrine, but that, on the contrary, the design was to follow it and to protect lienholders by means of regulations concerning the mode of contracting and dealing with property for the purposes of erecting improvements thereon. The first declaration on the subject is that the liens provided in the chapter shall be "direct liens" (whatever that may mean), and that persons, other than the contractor, shall not be limited by the contract price "except as hereinafter provided." The proviso referred to is found in the following declaration in the same section:
>
> "It is the intent and purpose of this section to limit the owner's liability, in all cases, to the measure of the contract price where he shall have filed or caused to be filed in good faith with his original contract a valid bond with good and sufficient sureties in the amount and upon the conditions as herein provided."
>
> A plainer declaration of the intention to make the contract price the limit of the owner's liability, where the bond and contract have been filed as required by this section, could scarcely be made.…

This lengthy quotation from *Roystone* provides a definitive exposition of the issues at a critical time when the contract era was giving way to the "direct lien" era following the 1911 amendments — in other words, a balancing of interests, formerly thought unconstitutional, that permits owners to be charged twice for the same work.

Roystone did not overrule the earlier cases; the court upheld the new payment bond statute through the guise of declaring it to be consistent in intent with 60 years of case law. Experience since 1911 shows that the 50% payment bond has not served the purpose envisioned by the *Roystone* court of substituting for the protections in the old contract cases. This is particularly true in the home improvement context, where payment bonds are a rarity.

The court had occasion to reflect on the significance of *Roystone* with respect to limitations on legislative power in *Pacific Portland Cement Co. v. Hopkins.*[37] Responding to the appellant supplier's arguments, a three-judge department of the full court wrote:

> The final point made is that, since the Constitution gives a lien on property upon which labor is bestowed or materials furnished (Const. art. XX, sec. 15), the legislature has no power to enact a statute which shall limit the lien-claimant's recovery to the unpaid portion of the contract price. Whatever might be thought of this as an original question, it is no longer open or debatable in this court. In the recent case of *Roystone Co. v. Darling* … we reviewed the long line of decisions which had established in this state the soundness of the rule that "if there is a valid contract, the contract price measures the limit of the amount of liens which can be acquired against the property by laborers and materialmen." In the present case, the portion of the contract price applicable to the payment of liens was fixed in accordance with the rule laid down in section 1200 of the Code of Civil

37. 174 Cal. 251, 254-55, 162 P. 1016 (Cal., Jan 24, 1917).

> Procedure. That the specific method provided by this section is not in conflict with the Constitution was expressly decided in *Hoffman Marks Co. v. Spires*, 154 Cal. 111, 115. The findings show that there was no unpaid portion of the contract price applicable to the payment of claimants who had furnished labor or materials to the original contractor. The conclusion of law that the defendant was entitled to judgment necessarily follows.

This review of the statutory, constitutional, and case law history from the earliest days until the dawning of the "direct lien" era demonstrates that limiting the owner's liability to the unpaid contract price was not only constitutional, but recognized as the expected standard against which variations had to be judged. The constitutional shoe was on the other foot in this era, with the burden of proving constitutionality on those who would limit or condition this well-understood principle.

Scope of Legislative Authority

The Legislature has significant discretion in meeting its constitutional duties. In fashioning its implementation of the constitutional direction to "provide, by law, for the speedy and efficient enforcement" of mechanic's liens, the Legislature is required to balance the interests of affected parties.

The constitutional language "shall have a lien" might appear to directly create a mechanic's lien, and courts have occasionally dealt with the argument that there is a "constitutional lien," somehow distinct from the statutory implementation. In an early case, the court described it as follows:[38]

> This declaration of a right, like many others in our constitution, is inoperative except as supplemented by legislative action.
>
> So far as substantial benefits are concerned, the naked right, without the interposition of the legislature, is like the earth before the creation, "without form and void," or to put it in the usual form, the constitution in this respect is not self-executing.

Cases have distinguished between the constitutional right to the lien and the statutory lien itself.[39] The constitutional provision is "not self-executing and is inoperative except to the extent the Legislature has provided by statute for the exercise of the right."[40] The court in the leading case of *Frank Curran Lumber Co. v. Eleven Co.*[41] explained that the constitution is

> inoperative except as supplemented by the Legislature through its power reasonably to regulate and to provide for the exercise of the right, the manner of

38. Spinney v. Griffith, 98 Cal. 149, 151-52, 32 P. 974 (1893).

39. See, e.g., Solit v. Tokai Bank, Ltd., 68 Cal. App. 4th 1435, 1445-47, 81 Cal. Rptr. 2d 243 (1999); Koudmani v. Ogle Enter., Inc., 47 Cal. App. 4th 1650, 1655-56, 55 Cal. Rptr. 2d 330, (1996).

40. Wilson's Heating & Air Conditioning v. Wells Fargo Bank, 202 Cal. App. 3d 1326, 1329, 249 Cal. Rptr. 553 (1988); Morris v. Wilson, 97 Cal. 644, 646, 32 P. 801 (1893).

41. 271 Cal. App. 2d 175, 183, 76 Cal. Rptr. 753 (1969).

> its exercise, the time when it attached, and the time within which and the persons against whom it could be enforced. *The constitutional mandate is a two-way street, requiring a balancing of the interests of both lien claimants and property owners.* In carrying out this constitutional mandate the Legislature has the duty of balancing the interests of lien claimants and property owners.[42]

It is this balancing of interests that the Commission has sought in preparing its recommendation, and that the Legislature must do whenever significant amendments are made affecting right to a mechanic's lien.

Purpose and Justification of Lien

The mechanic's lien was unknown at common law. The early cases adopted the traditional strict construction approach to the statute.[43] The lien is usually justified on the ground that the lien claimant has increased the value of the owner's property through labor, services, or materials supplied, and it would unjustly enrich the owner if the benefits could be enjoyed without payment.[44] Thus, it is fitting that the laborer and supplier should follow the fruits of their activities into the building (and some land) that has been enhanced.

Traditionally the measure of the lien has been tied to a contract price or the value of the claimant's contribution, however, not a specific measure of the increase in the value brought about by the claimant's enhancements through labor and supplies. Where the owner has paid the amounts owing under the contract, the unjust enrichment argument fades away and provides no support for requiring the owner to pay subcontractors and suppliers who did not receive payments from the contractor with whom they did business.

Original Intent of Constitutional Provision

There is strong evidence that the constitutional language was not meant to impose double liability on property owners. The language of the mechanic's lien provision placed in Article XX, Section 15, was discussed in some detail, as recorded in the Debates and Proceedings of the California Constitutional Convention of 1878-79.[45] The Convention soundly rejected proposed language to make clear that "no payment by the owner … shall work a discharge of a lien." This rejection took place with the certain knowledge that the Supreme Court had consistently held that liens were limited to the contract price under the statutes in force at the time.

In reviewing the constitutional history, one analyst has concluded:

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42. 271 Cal. App. 2d at 183 (emphasis added).

43. See, e.g., Bottomly v. Grace Church, 2 Cal. 90, 91 (1852).

44. See, e.g., Avery v. Clark, 87 Cal. 619, 628, 25 P. 919 (1891).

45. For further discussion and excerpts from the Debates and Proceedings relevant to mechanic's liens, see Second Supplement to Commission Staff Memorandum 2000-9, Exhibit pp. 9-11, 20-24.

> [T]he delegates clearly left the decision regarding the enforcement of liens for the Legislature to determine by statute. In rejecting the amendment, the delegates preserved the right of [the] Legislature to enact reasonable regulations limiting mechanic's liens, including statutes that grant homeowners a defense based on full payment. When viewed within the context of the Debates and Proceedings, the very system that is now in place was in fact rejected by the delegates of the Constitution Convention.[46]

This constitutional history has been usefully summarized in a law review comment as follows:

> The delegates participating in the debate were obviously aware of the fact than an earlier decision had construed mechanics' liens as limited to the amount found due and owing to the contractor. The drafting committee reported out the provision in the form in which it was ultimately enacted.
>
> A Mr. Barbour introduced an amended version which would have made the liens unlimited and would also have made the owner personally liable for them. There was some talk of revising the offered amendment to eliminate the feature of personal liability while retaining unlimited lien liability. Such a revision was never made, so the delegates never had the opportunity to vote on the simple issue of limited versus unlimited liens. The proponents of the Barbour amendment indicated that their primary interest was in aiding the laborer; materialmen were included as potential lienors without any real reason for including them advanced. No one contended that it was proper that an innocent homeowner should be subjected to "double payment." Instead, the proponents of the amendment assumed that the honest owner would be fully aware of the law and be able to protect himself. The principal argument in support of the Barbour amendment was that it would prevent "collusion" between "thieving contractors and scoundrelly owners who connive to swindle the workman out of his wages." … The opponents of the amendment used some rather strong language in asserting their position. One called the amendment a "fraud" and "infirm in principle." At all events, the amendment was voted down. Since most of the speakers seemed to be of the opinion that unlimited liens would not be permitted under the constitution unless expressly authorized therein, the fact that the Barbour amendment was defeated would seem to indicate an intention on the part of the delegates that unlimited liens should not be allowed. This cannot be stated with certainty, however, since one of the delegates was of the opinion that the provision as ultimately enacted would leave the question of limited or unlimited liens up to the legislature. Thus, there remains the possibility that the delegates adopted his view, and decided to dump the question into the legislators' laps. It can be stated categorically that, since no one thought that innocent homeowners should be subjected to "double payment," the delegates did not give their stamp of approval in advance to the present scheme of mechanics' liens.[47]

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46. Keith Honda, Mechanics Lien Law Comments [Draft], p. 7 (Feb. 10, 2000) (attached to Second Supplement to Commission Staff Memorandum 2000-9, Exhibit p. 11).

47. Comment, *The "Forgotten Man" of Mechanics' Lien Laws — The Homeowner*, 16 Hastings L.J. 198, 217-18 (1964) [footnotes omitted]. Research has not revealed a single case, among nearly 900 mechanic's lien cases reported since 1879, that refers to the constitutional *Debates and Proceedings*. Fewer

A contrary interpretation of the debates is possible, since the Legislature in 1880 amended Code of Civil Procedure Section 1183 to provide that the lien "shall not be affected by the fact that no money is due, or to become due, on any contract made by the owner with any other party."[48] It is possible to conclude from the transcript that the debate resulted in a stand-off, with the extent of the lien left to later legislative determination. But even this interpretation of the original intent does not provide support for the position that the Legislature is powerless to limit, condition, or redirect certain mechanic's lien rights as a result of balancing competing interests. Both interpretations of the constitutional debates support the Legislature's power to limit liens for important policy reasons.

Limits on Legislative Power

Some authorities argue that restricting or eliminating the mechanic's lien right where the owner had paid the contractor in full would be unconstitutional.[49] Other authorities disagree.[50]

Since the particular question of limiting the homeowner's liability to amounts remaining unpaid under the contract has not been decided in modern times, those who believe this approach would be unconstitutional rely on quotations from the cases concerning the special status of the mechanic's lien. Great reliance is placed on two California Supreme Court cases decided in the last 25 years: *Connolly Development, Inc. v. Superior Court*[51] and *Wm. R. Clarke Corp. v. Safeco Insurance Co*.[52]

Connolly was a 4-3 decision upholding the constitutionality of the mechanic's lien statute against a challenge based on the claim that the imposition of the lien constituted a taking without due process. Strikingly, however, *Connolly* is not relevant to the question of whether a good faith payment exception to double liability for mechanic's lien claims would be constitutional — the constitutionality of the mechanic's lien statute itself was the issue in the case. In upholding the statute, *Connolly* employed a balancing of interests in determining whether the taking without notice could withstand constitutional scrutiny. For the purposes of the Commission's proposal, *Connolly* is of interest because it illustrates that balancing of creditors' and debtors' rights must occur in considering mechanic's

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than 10 cases have discussed the "double payment" problem, and none of them reviewed the original intent of the framers of the constitutional mechanic's lien right.

48. 1880 Cal. Code Amends. ch. 67, § 1.

49. See, e.g., Hunt Report Part 2, *supra* note 5; see also First Supplement to Commission Staff Memorandum 2000-26; Abdulaziz memorandum (attached to First Supplement to Commission Staff Memorandum 2000-36).

50. See, e.g., Honda, *supra* note 46 Acret letter (Aug. 25, 1999) (quoted in Honda, *id.* at 2-5).

51. 17 Cal. 3d 803, 553 P. 2d 637, 132 Cal. Rptr. 477 (1976) (upholding mechanic's lien statute against due process attack).

52. 15 Cal. 4th 882, 938 P. 2d 372, 64 Cal. Rptr. 2d 578 (1997) (pay-if-paid contract provision held unconstitutional).

lien issues. This case is not relevant to the issue of whether the Legislature can constitutionally balance the interests of homeowners and mechanic's lien claimants through a rule protecting the owner from double payment liability.

In *Wm. R. Clarke Corp. v. Safeco* a divided court struck down pay-if-paid clauses in contracts between contractors and subcontractors. *Clarke* involved *contractual* waivers of an important constitutional right which were found to be *against* legislated public policy. The analysis undertaken in *Clarke* is clearly distinct from that required to determine whether a new public policy established by statute, in which the Legislature has balanced the competing interests, can properly be balanced against the lien right. In *Clarke* the owner had not paid and the surety company was trying to avoid paying. These equities are quite different from the situation addressed in the Commission's proposal, which addresses cases where the owner has already paid in good faith.

Most relevant to an understanding of the extent of the Legislature's power to shape the implementing statute and to condition and limit the broad constitutional language are the following:

Roystone, quoted at length above, is probably the most significant decision because it held the 1911 payment bond reform valid and attempted to harmonize the contract rule. Justice Henshaw's lone concurring opinion in *Roystone*[53] — to the effect that it is "wholly beyond the power of the Legislature to destroy or even impair this lien" — was an extreme minority opinion even then.

Martin v. Becker[54] contains some strong language about the sanctity of the mechanic's lien: "[T]he lien of the mechanic in this state … is a lien of the highest possible dignity, since it is secured not by legislative enactment but by the constitution.… Grave reasons indeed must be shown in every case to justify a holding that such a lien is lost or destroyed." This language is directed toward the exercise of judicial authority in a case where the court was called upon to determine whether the right to a mechanic's lien was lost when the claimant had

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53. 171 Cal. at 544. Justice Henshaw appears to have believed that even the 50% bonding provision was suspect:

> The owner may have paid the contractor (and he is not prohibited from so doing) everything that is due, and in such case this language would limit the right of the recovery of the lien claimant to what he could obtain under the bond. In short, he would have no lien upon the property at all. Here is as radical a denial of the constitutional lien as is found in any of the earlier statutes. The inconsistency between this language and other parts of the act is too apparent to require comment. Yet, as this seems to have been the deliberate design of the legislature, it is perhaps incumbent upon this court under its former decisions to give that design legal effect. If the legislature in fact means to give claimants the rights which the constitution guarantees them, as it declares its desire to do in section 14 [of 1911 Cal. Stat. ch. 678] …, it alone has the power to do so by language which will make it apparent that a lien claimant may still have recourse to the property upon which he has bestowed his labor if the interposed intermediate undertaking or fund shall not be sufficient to pay him in full. This court is, however, justified, I think, in waiting for a plainer exposition of the legislature's views and intent in the matter than can be found in this confused and confusing statute.

Id. at 546. Missing from this concurring opinion is any notion of balancing the rights of the owner.

54. 169 Cal. 301, 316, 146 P. 665 (1915).

also obtained security by way of a mortgage. Although the court's sentiments may be sound, they are irrelevant to the standards for reviewing a legislative determination of the proper balance between competing interests.

Judicial recognition that the state has a "strong policy" favoring laws giving laborers and materialmen security for their liens[55] addresses only one element in the Legislative balancing process and does not tell us the outcome were the Legislature to determine that the owner of a single-family, owner-occupied dwelling needs special protection from the risk of having to pay twice.

In *English v. Olympic Auditorium*,[56] the court wrote: "Should the lien laws be so interpreted as to destroy the liens because the leasehold interest has ceased to exist, such interpretation would render such laws unconstitutional." But in this case there was no double payment — there was not even a single payment. The court ruled that mechanic's liens remained on a structure built by the lessee whose lease had terminated, notwithstanding the lease provision making any construction a fixture inuring ultimately to the lessor's benefit.

Young v. Shriver[57] has been cited for the felicitous language "we presume that no one will say that the right to the remedy expressly authorized by the organic law can be frittered away by any legislative action or enactment." But this is a case where the court rejected a mechanic's lien claim for the labor of plowing agricultural land, and involved the technicalities of distinguishing between the first plowing and later plowings. The court did not find plowing at any time to be an "improvement" within the constitutional or statutory language.

Hammond Lumber Co. v. Barth Investment Corp.[58] repeats the *Martin v. Becker* language in a case concerning a technical question of whether a building had actually been completed for purposes of a 90-day lien-filing period. The court wrote: "The function of the legislature is to provide a system through which the rights of mechanics and materialmen may be carried into effect, and this right cannot be destroyed or defeated either by the legislature or courts, unless grave reasons be shown therefor." This case did not involve an issue of the scope of the Legislature's power to "destroy or defeat" the lien upon a showing of grave reasons.

Hammond v. Moore[59] resolved the issue whether the Land Title Law, enacted by initiative, violated the mechanic's lien provision in the constitution. The court found that the lien recording requirement was not unduly burdensome, and in dicta speculated that "the second sentence of section 93, by denying the creation of a lien unless the notice is filed, violates the forepart of article XX, section 15, of the

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55. E.g., Connolly Dev., Inc. v. Superior Court, 17 Cal. 3d 803, 827, 553 P.2d 637, 132 Cal. Rptr. 447 (1976).

56. 217 Cal. 631, 20 P.2d 946 (1933).

57. 56 Cal. App. 653, 655-66, 206 P. 99 (1922).

58. 202 Cal. 606, 610, 262 P. 31 (1927).

59. 104 Cal. App. 528, 286 P. 504 (1930).

Constitution, granting a lien/" But that issue was not before the court, and similar procedural requirements have been accepted in the mechanic's lien law for years without challenge.

The source of some interesting language cited in a number of later cases is *Diamond Match Co. v. Sanitary Fruit Co.*:[60]

> The right of mechanics, materialmen, etc., to a lien upon property upon which they have bestowed labor, or in the improvement of which material which they have furnished have been used, for the value of such labor or materials, is guaranteed by the Constitution, the mode and manner of the enforcement of such right being committed to the Legislature.… Manifestly, the legislature is not thus vested with arbitrary power or discretion in attending to this business. Indeed, rather than power so vested in the legislature, it is a command addressed by the constitution to the law-making body to establish a reasonably framed system for enforcing the right which the organic law vouchsafes to the classes named. Clearly, it is not within the right or province of the legislature, by a cumbersome or ultratechnical scheme designed for the enforcement of the right of lien, to impair that right or unduly hamper its exercise. Every provision of the law which the Legislature may enact for the enforcement of the liens … must be subordinate to and in consonance with that constitutional provision.…
>
> But, while all that has been said above is true, it will not be denied that it is no less the duty of the legislature, in adopting means for the enforcement of the liens referred to in the constitutional provision, to consider and protect the rights of owners of property which may be affected by such liens than it is to consider and protect the rights of those claiming the benefit of the lien laws. The liens which are filed under the lien law against property, as a general rule, grow out of contracts which are made by and between lien claimants and persons (contractors) other than the owner of the property so affected, and such liens may be filed and so become a charge against property without the owner having actual knowledge thereof. The act of filing, as the law requires, constitutes constructive notice to the owners and others that the property stands embarrassed with a charge which will operate as a cloud upon the title thereof so long as the lien remains undischarged, and that the property may be sold under foreclosure proceedings unless the debt to secure which the lien was filed is otherwise sooner satisfied. The filing of the claim in the recorder's office is intended to protect the owner of the property against double payment to the contractor or payment for his services and the materials he uses in the work of improvement in excess of what his contract calls for. The notice is also intended for the protection of those who may, as to such property, deal with the owner thereof — that is, third persons as purchasers or mortgagees.

In this case, the court held the claimant to the statutory requirement that the owner's name be stated correctly on the lien claim, since otherwise no one examining the record index would know that the claim had been filed as to the owner's property.

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60. 70 Cal. App. 695, 701-02, 234 P. 322 (1925).

There is also a presumption in favor of the validity of statutes which may be applied to uphold legislative balancing of different interests in the mechanic's lien context. Legislative discretion was discussed in *Alta Building Material Co. v. Cameron* as follows:[61]

> The following language in *Sacramento Municipal Utility Dist. v. Pacific Gas & Elec. Co*., 20 Cal. 2d 684, 693, [128 P.2d 529] is applicable: "The contention that the section in question [Code Civ. Proc. § 526b] lacks uniformity, grants special privileges and denies equal protection of the laws, is also without merit. None of those constitutional principles is violated if the classification of persons or things affected by the legislation is not arbitrary and is based upon some difference in the classes having a substantial relation to the purpose for which the legislation was designed. [Citations.] … Wide discretion is vested in the Legislature in making the classification and every presumption is in favor of the validity of the statute; the decision of the Legislature as to what is a sufficient distinction to warrant the classification will not be overthrown by the courts unless it is palpably arbitrary and beyond rational doubt erroneous. [Citations.] A distinction in legislation is not arbitrary if any set of facts reasonably can be conceived that would sustain it." (See also: *Dribin v. Superior Court*, 37 Cal. 2d 345, 351-352 [231 P.2d 809, 24 A.L.R.2d 864]; *City of Walnut Creek v. Silveira*, 47 Cal. 2d 804, 811 [306 P.2d 453].)
>
> While the essential purpose of the mechanics' lien statutes is to protect those who have performed labor or furnished material towards the improvement of the property of another (*Nolte v. Smith*, 189 Cal. App. 2d 140, 144 [11 Cal. Rptr. 261], inherent in this concept is a recognition also of the rights of the owner of the benefited property. It has been stated that the lien laws are for the protection of property owners as well as lien claimants (*Shafer v. Los Serranos Co.*, 128 Cal. App. 357, 362 [17 P.2d 1036]) and that our laws relating to mechanics' liens result from the desire of the Legislature to adjust the respective rights of lien claimants with those of the owners of property improved by their labor and material. (*Corbett v. Chambers*, 109 Cal. 178, 181 [41 P. 873].) As stated in *Diamond Match Co. v. Sanitary Fruit Co.*, 70 Cal. App. 695 [234 P. 322], at 701: "[I]t is no less the duty of the Legislature, in adopting means for the enforcement of the liens referred to in the constitutional provision, to consider and protect the rights of owners of property which may be affected by such liens than it is to consider and protect the rights of those claiming the benefit of the lien laws. The liens which are filed under the lien law against property, as a general rule, grow out of contracts which are made by and between lien claimants and persons (contractors) other than the owner of the property so affected, and such liens may be filed and so become a charge against property without the owner having actual knowledge thereof."
>
> Viewing section 1193 within the framework of these principles, we are unable to state that the Legislature acted arbitrarily and unreasonably in making the classification which it did.
>
> The section does not require a pre-lien notice by those under direct contract with the owner or those who perform actual labor for wages on the property. The logical reason for this distinction is that the owner would in the usual situation be

61. 202 Cal. App. 2d 299, 303-04, 20 Cal. Rptr. 713 (1962).

> apprised of potential claims by way of lien in connection with those with whom he contracts directly, as well as those who perform actual labor for wages upon the property.
>
> However, as to materials furnished or labor *supplied* by persons not under direct contract with the owner, it may be difficult, if not impossible, for the owner to be so apprised and the clear purpose of section 1193 is to give the owner 15 days' notice in such a situation that his property is to be "embarrassed with a charge which will operate as a cloud upon the title thereof so long as the lien remains undischarged, and that the property may be sold under foreclosure proceedings unless the debt to secure which the lien was filed is otherwise sooner satisfied." (*Diamond Match Co. v. Sanitary Fruit Co., supra*, p. 702.)

The court in *Alta Building Material* distinguished the Supreme Court case of *Miltimore v. Nofziger*,[62] a 4-3 decision holding unconstitutional a statutory rule giving priority to laborers over material suppliers in satisfaction of mechanic's lien claims against the proceeds from the sale of the liened property.[63] Although *Miltimore* is short on detail, the *Alta Building Material* court concluded that *Miltimore* involved classifications "as to substantive matters," whereas Section 1193 at issue in *Alta Building Material* involved a procedural matter — "the right itself is not denied or impaired."

Balancing Interests

There have been a number of schemes implementing the constitutional direction since 1879, and several statutory provisions have been challenged for being unconstitutional as measured against the language of the constitution. Throughout the years, the courts have rejected most constitutional challenges to aspects of the statutes, recognized a number of exceptions to the scope of the constitutional provision, and generally have deferred to the Legislature's balancing of the interests. Of course, the Legislature can't ignore the constitutional language, but the case law does not yet indicate the limit of statutory balancing of the respective interests.

In early cases, the fundamental property rights of the owner received frequent judicial attention. For example, in the course of striking down the statute requiring payment of construction contracts in money, the court in *Stimson Mill Co. v. Braun*[64] explained:

> The provision in the constitution respecting mechanics' liens (art. XX 20, sec. 15) is subordinate to the Declaration of Rights in the same instrument, which declares (art. I, sec. 1) that all men have the inalienable right of "acquiring, possessing and protecting property," and (in sec. 13) that no person shall be deprived of property "without due process of law." The right of property antedates

62. 150 Cal. 790, 90 P. 114 (1907).

63. Subcontractors and original contractors were ranked third and fourth under Code of Civil Procedure Section 1194, as amended by 1885 Cal. Stat. ch. 152, § 4.

64. 136 Cal. 122, 125, 68 P. 481 (1902).

all constitutions, and the individual's protection in the enjoyment of this right is one of the chief objects of society.

In considering whether it was constitutionally permissible to make procedural distinctions between different classes of lien claimants, the Supreme Court explained in *Borchers Bros., v. Buckeye Incubator Co.*:[65]

> The problem is therefore presented whether the Legislature's procedural distinction in section 1193 of the Code of Civil Procedure, requiring notice by a materialman but not by a laborer, is so arbitrary and unreasonable that there is no substantial relation to a legitimate legislative objective.
>
> The constitutional mandate of article XX, section 15, is a two-way street, requiring a balancing of the interests of both lien claimants and property owners. First, this argument could appropriately be presented to the Legislature and not to the courts. Second, in carrying out this constitutional mandate, the Legislature has the duty of balancing the interests of lien claimants and property owners.

Examples of "Balanced Interests"

A number of situations where the Legislature has balanced competing interests is evident in the cases discussed above. Other mechanic's lien balancing acts include: the limitation of lien rights to licensed contractors; the statutory notice of nonresponsibility that frees an owner from liability for tenant improvements, even though they benefit the owner; the priority of future advances under a prior deed of trust; the exemption for public works.

With respect to this history of balancing interests, one expert has concluded:

> In each of these cases, the legislature has made a policy decision that the constitutional right to a mechanics lien should yield to legitimate interests of property owners.
>
> In one case, the legislature decided that a property owner should be protected against liens for work ordered by a tenant even though construction ordered by a tenant is just as valuable as any other construction. In another case, the legislature decided that it was more important to encourage construction financing by institutional lenders than to protect mechanics lien rights. In the last case, the legislature simply decided that public agencies should be exempt from mechanics lien claims.[66]

Licensed Contractor Limitation

Since 1931, unlicensed contractors have been precluded from recovering compensation "in law or equity in any action," including foreclosure of mechanic's liens.[67] In *Alvarado v. Davis*,[68] the court denied enforcement of a

65. 59 Cal. 2d 234, 238, 379 P.2d 1, 28 Cal. Rptr. 697 (1963).

66. Acret Letter, *supra* note 50.

67. See 1931 Cal. Stat. ch. 578, § 12.

68. 115 Cal. App. Supp. 782, 783 (1931).

mechanic's lien by an unlicensed contractor based on the licensing requirement enacted in 1929, even before the statute provided an explicit bar.[69]

The current rule is set out in Business and Professions Code Section 7031. The courts have affirmed the intent of the Legislature "to enforce honest and efficient construction standards" for the protection of the public.[70] The severe penalty in the nature of a forfeiture caused some unease when courts were faced with technical violations of the licensing statute, giving rise to the substantial compliance doctrine.[71] The Legislature acted to rein in the substantial compliance doctrine by amendments starting in 1991 restricting the doctrine to cases where the contractor has been licensed in California, had acted reasonably and in good faith to maintain licensure, but did not know or reasonably should not have known of the lapse.[72]

In *Vallejo Development Co. v. Beck Development Co.*,[73] the court reaffirmed the authority of the licensing rules:

> California's strict contractor licensing law reflects a strong public policy in favor of protecting the public against unscrupulous and/or incompetent contracting work. As the California Supreme Court recently reaffirmed, "The purpose of the licensing law is to protect the public from incompetence and dishonesty in those who provide building and construction services.… The licensing requirements provide minimal assurance that all persons offering such services in California have the requisite skill and character, understand applicable local laws and codes, and know the rudiments of administering a contracting business."

The constitutional mechanic's lien provision predates the licensing regime by 50 years. The decisions do not question the propriety of this major limitation on the constitutional lien. Even though a disfavored forfeiture can result from application of the licensing rules, the mechanic's lien right bows before the policy of protecting the public implemented in the licensing statute.[74]

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69. See 1929 Cal. Stat. ch. 791, § 1.

70. See Famous Builders, Inc. v. Bolin, 264 Cal. App. 2d 37, 40-41, 70 Cal. Rptr. 17 (1968); Cash v. Blackett, 87 Cal. App. 2d 233, 237, 196 P. 2d 585 (1948).

71. See, e.g., Latipac, Inc. v. Superior Court, 64 Cal. 2d 278, 279-80, 411 P.2d 564, 49 Cal. Rptr. 676 (1966).

72. Bus. & Prof. Code § 7031(d)-(e); see also Bus. & Prof. Code § 143 (general bar to recovery by unlicensed individuals and prohibition on application of substantial compliance doctrine).

73. 24 Cal. App. 4th 929, 938, 29 Cal. Rptr. 2d 669 (1994).

74. The scope of the licensing rules is limited. The bar only applies to those who are required to be licensed for the activity they are conducting. Thus, for example, a person who is hired as an employee to supervise laborers in constructing a house is not a contractor. See, e.g., Frugoli v. Conway, 95 Cal. App. 2d 518, 213 P.2d 76 (1950). Although there is no case deciding the issue, it is assumed that unlicensed contractors who are not required to be licensed because they only contract for jobs under $500 (see Bus. & Prof. Code § 7048) are still entitled to the mechanic's lien law remedies because the bar of Business and Professions Code Section 7031 would not apply to them.

Public Works

The statutes make clear that the mechanic's lien is not available in public works.[75] A "public work" is defined as "any work of improvement contracted for by a public entity."[76] The constitutional mechanic's lien provision does not contain this limitation.

The statutory rule appears first in 1969.[77] However, by 1891 the California Supreme Court had ruled that the constitutional mechanic's lien provision could not apply to public property as a matter of public policy. In *Mayrhofer v. Board of Education*,[78] a supplier sought to foreclose a lien for materials furnished to a subcontractor for building a public schoolhouse. Although the constitutional provision is unlimited in its use of "property" to which the lien attaches for labor or materials furnished, the court found that "the state is not bound by general words in a statute, which would operate to trench upon its sovereign rights, injuriously affects its capacity to perform its functions, or establish a right of action against it." [79] The court termed it "misleading to say that this construction is adopted on the ground of public policy," thus distinguishing this limitation on the scope of the mechanic's lien from other balancing tests. Rather, the interpretation follows from the original intent of the language to provide remedies for private individuals; it would be an "unnatural inference" to conclude otherwise.[80] Constitutional provisions for the payment of state debts through taxation and restrictions on suits against the state bolster the conclusion that general provisions like the mechanic's lien statute and its implementing legislation do not apply to the state and its subdivisions.[81]

Special Protections of Homeowner and Consumer Interests

Modern California law provides a number of special protections for homeowners.[82] This special treatment evidences legislative concern for this fundamental class of property and suggests the propriety of balancing that interest with the mechanic's lien right. This is not entirely a modern development. Just as

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75. Civ. Code § 3109.

76. Civ. Code § 3100; see also §§ 3099 ("public entity" defined), 3106 ("work of improvement" defined).

77. 1969 Cal. Stat. ch. 1362, § 2 (enacting Civ. Code § 3109)

78. 89 Cal. 110, 26 P. 646 (1891.

79. *Id.* at 112.

80. *Id.* at 113.

81. *Accord* Miles v. Ryan, 172 Cal. 205, 207, 175 P.5 (1916).

82. See, e.g., Bus. & Prof. Code § 10242.6 (prepayment penalties); Civ. Code §§ 2924f (regulation of powers of sale), 2949 (limitation on due-on-encumbrance clause), 2954 (impound accounts), 2954.4 (late payment charges).

the mechanic's lien is the only creditor's remedy with constitutional status, the homestead exemption is the only debtor's exemption constitutionally enshrined.[83]

The California codes are replete with consumer protection statutes that condition the freedom of contract and other fundamental rights. Particularly relevant is the Contractors' State License Law,[84] which contains numerous provisions limiting activities of contractors in the interest of consumer protection.

Other Constitutional Rulings

A few cases have held different aspects of the mechanic's lien statute unconstitutional and are noted below. These cases do not shed much light on the constitutionality of modern reform proposals addressing the double payment problem. In fact, as the older cases tended to favor contract rights over the rights of mechanic's lien creditors, they lend support to the Commission's proposal to protect good-faith payments under the homeowner's contract with the prime contractor.

Gibbs v. Tally[85] invalidated the mandatory bond provision in Code of Civil Procedure Section 1203, as enacted in 1893, as an unreasonable restraint on the owner's property rights and an unreasonable and unnecessary restriction on the power to make contracts.

Stimson Mill Co. v. Braun[86] held the requirement of payment in cash in the 1885 version of Code of Civil Procedure Section 1184 was unconstitutional as an interference with contract rights.

The allowance of attorney's fees as an incident to lien foreclosure under the 1885 version of Code of Civil Procedure 1195 was invalidated in *Builders' Supply Depot v. O'Connor*.[87]

The most relevant case is *Parsons Brinckerhoff Quade & Douglas, Inc. v. Kern County Employees Retirement Ass'n*,[88] cited in a recent Legislative Counsel's opinion.[89] Assembly Member Mike Honda requested an opinion from the Legislative Counsel on the following question:

> Would a statute be unconstitutional if it provides the owner of residential real property who pays a contractor in full for a work of improvement on the property with a defense against a mechanics' lien filed by a subcontractor who has bestowed labor on, or furnished material for, that work of improvement?

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83. See Cal. Const. art. XX, § 1.5 ("The Legislature shall protect, by law, from forced sale a certain portion of the homestead and other property of all heads of families.")

84. Bus. & Prof. Code §§ 7000-7191

85. 133 Cal. 373, 376-77, 65 P. 970 (1901) (distinguished in *Roystone*).

86. 136 Cal. 122, 125, 68 P. 481 (1902).

87. 150 Cal. 265, 88 P. 982 (1907).

88. 5 Cal. App. 4th 1264, 7 Cal. Rptr. 2d 456 (1992).

89. See Legis. Counsel Opinion #13279, May 11, 1999 (attached to Second Supplement to Commission Staff Memorandum 2000-9, Exhibit pp. 25-30) [hereinafter "Opinion"].

The Opinion concluded that such a statute would be unconstitutional. While it cites a broad statement in the case law concerning the legislative power in relation to the constitution,[90] the Opinion does not mention the limitations on the constitutional provision resulting from balancing competing policies, such as the contractor licensing rules, nor does it consider the constitutional history as reflected in the *Debates and Proceedings*. The Opinion does not mention the early case law, nor the statutes from 1885 to 1911, under which good faith payment to the prime contractor without notice of other claims acted as a shield against mechanic's liens.

Although the Opinion recognizes that the Legislature has "plenary power to reasonably regulate and provide for the exercise of this right, the manner of its exercise, the time when it attached, and the time within which and the persons against whom it could be enforced" it concludes:

> However, on the other hand, we think that a statute that provides the owner of residential real property with a defense against a mechanics' lien by a subcontractor whenever the owner pays a contractor in full would effectively deny the subcontractor the right to enjoy the benefits of the lien because a payment in full to the contractor does not necessarily protect the subcontractor's right to be paid.

The Commission does not believe this conclusion follows from the analysis.

The Opinion does not consider the requirement of legislative balancing between the interests of potential lien claimants and owners, as recognized in the lengthy text it quotes from the *Borchers* case. The Opinion does not analyze the interests involved in implementing the constitutional duty. The Opinion recognizes that failure to follow parts of the existing statutory procedure result in the loss of the lien right, but fails to consider how the defense of full payment might be implemented through similar notices, opportunities to object, demands, good-faith determinations and the like.

As the lengthy history of mechanic's liens in California prior to 1911 clearly shows, such a scheme can be and has been constitutionally implemented.

Probably the most meaningful point in the Opinion is the citation to *Parsons Brinckerhoff Quade & Douglas, Inc. v. Kern County Employees Retirement Ass'n*.[91] The Opinion cites this case for the proposition that "the Legislature, in carrying out its constitutional mandate … may not effectively deny a member of a protected class the benefits of an otherwise valid lien by forbidding its enforcement against the property of a preferred person or entity." But, as indicated above, *Parsons* involved the conflict between a special debtor's exemption statute and the mechanic's lien law. To uphold the exemption would mean that the fund would receive a windfall. This is not the situation where the homeowner has paid in full under the contract with the prime contractor. The proposal does not impose

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90. *Diamond Mine Co., supra.*

91. 5 Cal. App. 4th 1264, 7 Cal. Rptr. 2d 456 (1992).

a categorical exemption of homeowners from liability under home improvement contracts. In the absence of such a proposal, *Parsons* is not on point.

Constitutional Conclusion

The Commission's review of the constitutional issues leads to the conclusion that the proposal to protect good-faith payments by owners under home improvement contracts and protect subcontractors and suppliers by way of a payment bond involving contracts over a reasonable minimum contract amount would be constitutional. This follows from a review of the constitutional intent, case law history, statutory development, balancing tests, and the opinions of experts in the field on both sides of the issue (including Commission consultants), as well as a general sense of what is permissible consumer protection in the present era.

The Commission's review of scores of cases has not led to any clear idea of what the governing standard might be. Perhaps this is due to a lack of insight on the staff's part, but we have sought cases on point in the mechanic's lien area and have found little concrete guidance. Most judicial discourse on the nature of the constitutional provision, the role of the Legislature in implementing it, and other affirmations of the sanctity of the mechanic's lien appear in cases involving technical issues or establishing the basis for a liberal, remedial interpretation of the statute. By and large, the cases are not concerned with limiting legislative power or rejecting legislative determinations of the proper balance of interests based on larger policy concerns.

The standard recitations pertaining to the force of the constitutional language suggest a general inclination of the courts to honor the protection of mechanics, suppliers, laborers, subcontractors, and contractors. But at the same time, it must be recognized that the concrete results in these cases have been largely to uphold statutory qualifications and policy balancing, notwithstanding the breadth of the constitutional language.

PROPOSED LEGISLATION

Contents

☞ **Staff Note.** The proposed payment bond in home improvement contracts is an application of the existing rules in Chapter 6 (commencing with Section 3235) of Title 15 of Part 4 of Division 3 of the Civil Code — the mechanic's lien statute. For reference purposes, the text of Chapter 6 is set out below even though some of its provisions are not proposed to be amended in this recommendation.

The Commission is also considering a draft of a general revision of the mechanic's lien statute set out in Title 15 (Civ. Code §§ 3082-3267) and related provisions in the Contractors' State License Law (Bus. & Prof. Code §§ 7000-7191). See Memorandum 2001-71. The draft general revision would, and would include revisions of the unchanged sections set out below. Eventually, if both recommendations move forward, they will be coordinated.

CHAPTER 6. PAYMENT BOND FOR PRIVATE WORKS

Article 1. Provision for and Effect of Filing Contract and Payment Bond

Civ. Code § 3235 [unchanged]. Fifty percent payment bond

3235. In case the original contract for a private work of improvement is filed in the office of the county recorder of the county where the property is situated before the work is commenced, and the payment bond of the original contractor in an amount not less than 50 percent of the contract price named in such contract is recorded in such office, then the court must, where it would be equitable so to do, restrict the recovery under lien claims to an aggregate amount equal to the amount found to be due from the owner to the original contractor and render judgment against the original contractor and his sureties on such bond for any deficiency or difference there may remain between such amount so found to be due to the original contractor and the whole amount found to be due to claimants.

☞ **Staff Note.** The language "where it would be equitable so to do" is troublesome, if it is not read narrowly. It dates back to 1911 (see Code Civ. Proc. § 1183, as amended, 1911 Cal. Stat. ch. 681, § 1) and has been mentioned in a handful of cases. See, e.g., Merner Lumber Co. v. Brown, 218 Cal. 136, 21 P.2d 590, 592-93 (1933); S.R. Frazee Co., v. Arnold, 46 Cal. App. 74, 77, 188 P. 822 (1920) (not equitable to limit recovery where sureties on bond required by owner were not sufficient).

In the scheme under Article 3, where the prime contractor supplies a corporate surety bond, it would be sufficient that the owner has paid in good faith. The court should not be invited to reexamine the equities in applying the statutory rule that is intended to address the double payment problem, nor should parties be encouraged to litigate the matter in the hope that a court might limit the intended statutory protection. Accordingly, this language does not appear in the proposed Article 3 (commencing with Section 3244) applicable to home improvement contracts. In the general revision draft, the staff will propose revisions of Section 3235 to replace the "equitable so to do" clause.

• **Reminder:** Most Staff Notes will be omitted from this material before any tentative recommendation approved by the Commission is circulated for comment.

Civ. Code § 3236 [unchanged]. Purpose, limitation on owner's liability

3236. It is the intent and purpose of Section 3235 to limit the owner's liability, in all cases, to the measure of the contract price where he shall have filed or caused to be filed in good faith his original contract and recorded a payment bond as therein provided. It shall be lawful for the owner to protect himself against any failure of the original contractor to perform his contract and make full payment for all work done and materials furnished thereunder by exacting such bond or other security as he may deem necessary.

☞ **Staff Note.** This section will be revised in connection with a general revision. There should not be a good faith issue at the time of filing the contract and recording the bond, but only later (if at all), when payments are made. The language of this section dates back to the struggles of the late 1800s and early 1900s concerning contract rights and the extent to which bonds could be required.

Civ. Code § 3237 [unchanged]. Lender's objection

3237. When a lending institution requires that a payment bond be furnished as a condition of lending money to finance a private work of improvement, and accepts in writing as sufficient a payment bond posted in fulfillment of this requirement, it may thereafter object to the borrower as to the validity of that payment bond or refuse to make the loan based upon any objection to the payment bond only if the bond underwriter was licensed by the Department of Insurance.

As used in this section, "lending institution" includes commercial banks, savings and loan institutions, credit unions, and any other organizations or persons that are engaged in the business of financing loans.

☞ **Staff Note.** This section will be revised in connection with a general revision. At a minimum, it should be revised to eliminate the second paragraph and to use the term "construction lender" defined in Section 3087.

Article 2. Conditions to Action on Payment Bond

Civ. Code § 3239 (amended). Invalidity of provisions limiting actions

SEC. ____. Section 3239 of the Civil Code is amended to read:

3239. (a) ~~No~~ A provision in ~~any~~ a payment bond given pursuant to ~~any of the provisions of this chapter~~ Article 1 (commencing with Section 3235) attempting ~~by contract~~ to shorten the period prescribed in Section 337 of the Code of Civil Procedure for the commencement of an action ~~thereon shall be~~ on the bond is not valid if ~~such provision~~ it attempts to limit the time for commencement of an action ~~thereon~~ on the bond to a shorter period than six months from the completion of ~~any~~ the work of improvement~~, nor shall any~~.

(b) A provision in ~~any of such bonds~~ a payment bond given pursuant to Article 1 (commencing with Section 3235) attempting to limit the period for the commencement of ~~actions thereon be~~ an action on the bond is not valid insofar as ~~actions~~ an action brought by ~~claimants are~~ a claimant is concerned, unless ~~such~~ the bond is recorded, before the work of improvement is commenced, with the county recorder of the county in which the property referred to ~~therein~~ in the bond is situated.

Comment. Section 3239 is amended to make clear that the general rules on limiting actions to recover on payment bonds do not apply to home improvement payment bonds under Article 3 (commencing with Section 3244). A six-month rule applies to home improvement payment bonds, as provided in Section 3240. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3096 ("payment bond" defined), 3106 ("work of improvement" defined).

☞ **Staff Note.** In amendments to Sections 3239 and 3240, the staff proposes to apply a standard six-month limitations period for actions on bonds. This would not be subject to contractual control and would not depend on whether the bond is recorded before work commences.

Civ. Code § 3240 (amended). Time to bring action after bond recorded

SEC. ____. Section 3240 of the Civil Code is amended to read:

3240. Notwithstanding Section 3239, if a surety on ~~any~~ a payment bond given pursuant to ~~this chapter~~ Article 1 (commencing with Section 3235), or a prime contractor as principal on a home improvement payment bond given pursuant to Article 3 (commencing with Section 3244), records the payment bond in the office of the county recorder of the county in which the property is situated before the work of improvement is completed, then any action ~~against the surety or sureties~~ on the bond shall be commenced not later than six months after the completion of the work of improvement.

Comment. Section 3240 is amended to apply the six-month limitation period to actions on home improvement payment bonds under Article 3. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3096 ("payment bond" defined), 3098.5 ("prime contractor" defined), 3106 ("work of improvement" defined).

Civ. Code § 3242 (amended). Claim against payment bond

SEC. ____. Section 3242 of the Civil Code is amended to read:

3242. (a) With regard to a contract entered into on or after January 1, 1995, in order to enforce a claim ~~upon any~~ on a payment bond given in connection with a private work of improvement, a claimant shall give the preliminary 20-day ~~private work preliminary~~ notice (private work) provided in Section 3097.

(b) If the preliminary 20-day ~~private work preliminary~~ notice (private work) was not given as provided in Section 3097, a claimant may enforce a claim by giving written notice to the surety and the bond principal as provided in Section 3227 within 15 days after recordation of a notice of completion. If no notice of completion has been recorded, the time for giving written notice to the surety and the bond principal is extended to 75 days after completion of the work of improvement.

(c) This section does not apply to home improvement payment bonds given under Article 3 (commencing with Section 3244).

Comment. Subdivision (c) is added to Section 3242 to make clear that the preliminary notice is not required under the mandatory home improvement payment bond provisions in Article 3. Since payment bonds under Article 3 are required to be recorded and no preliminary 20-day notice is required, the limitations in Section 3240 apply. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3085 ("claimant" defined), 3096 ("payment bond" defined), 3097 ("preliminary 20-day notice (private work)" defined), 3093 ("notice of completion" defined).

☞ **Staff Note.** Another option would be to exclude home improvement contracts from operation of this section and provide special rules for claims against the Article 3 payment bond.

Civ. Code §§ 3244-3244.60 (added). Home improvement payment bonds

SEC. ____. Article 3 (commencing with Section 3244) is added to Chapter 6 of Title 15 of Part 4 of Division 3 of the Civil Code, to read:

Article 3. Home Improvement Payment Bonds

§ 3244. Scope of article

3244. Notwithstanding any other provision in this title, this article governs the rights of claimants and the liabilities of owners under home improvement contracts, as defined in Section 7151.2 of the Business and Professions Code.

Comment. Section 3244 makes clear that this article governs enforcement of claims by way of mechanic's liens, bond claims, and stop notices, and any other means, in the case of home improvement contracts. Specific limitations have been amended into a number of other provisions in this title, but the introductory clause is intended to make clear that this article governs home improvement contracts in the case of a conflict with another provision. See, e.g., Sections 3097(q), 3123(a), 3159(a)(1)-(2), 3161(a), 3162(a)(1)-(2).

See also Sections 3085 ("claimant" defined), 3095 ("owner" defined).

☞ **Staff Note.** The definition of "owner" is in the general revision draft. The incorporation of the home improvement contract definition in this section might be replaced with a provision in the definition chapter in this title, having the same effect.

§ 3244.10. Fifty percent payment bond

3244.10. (a) Before work commences under a home improvement contract in the amount of ten thousand dollars ($10,000) or more, the prime contractor shall obtain a payment bond in an amount not less than 50 percent of the contract price, and shall file the home improvement contract and record the bond with the county recorder of the county where the subject of the contract is situated.

(b) An increased or supplemental payment bond shall be recorded as provided in subdivision (a) if changes have the effect of increasing the price stated in the contract by 10 percent or more, in which case the total bond amount shall be increased to not less than 50 percent of the increased contract price.

(c) If the prime contractor has not filed the home improvement contract and recorded a bond under subdivision (a) because the contract is in an amount under ten thousand dollars ($10,000), the prime contractor shall comply with subdivision (a) where changes have the effect of increasing the total contract price to ten thousand dollars ($10,000) or more.

Comment. Subdivision (a) of Section 3244.10 provides for a mandatory payment bond to be obtained by the prime contractor and recorded, along with a filed copy of the home improvement contract. This provision is drawn from Section 3235.

The requirement for increasing the bond in subdivision (b) is consistent with the rule under Section 3123(c) requiring the owner to notify the prime contractor and construction lender where changes increase the contract price by 5 percent or more. The 10 percent amount is employed in this section because the bond is given for 50% of the increase, equivalent to the 5 percent standard in Section 3123(c).

Subdivision (c) makes clear that a contract may become subject to the bonding requirement in subdivision (a) as a result of changes increasing the contract price over the threshold amount.

See also Sections 3096 ("payment bond" defined), ____ ("prime contractor" defined), 3244 (incorporation of "home improvement contract" definition).

☞ **Staff Note.** The definition of "prime contractor" is in the general revision draft.

§ 3244.20. Bond requirements

3244.20. (a) A payment bond under this article shall be executed by an admitted surety insurer.

(b) A deposit in lieu of bond is not sufficient under this article.

(c) A prime contractor's blanket payment bond providing coverage equivalent to the payment bond described in Section 3244.10, and satisfying regulations of the Contractors' State License Board, may be used instead of an individual payment bond for each home improvement contract. Equivalent coverage by a blanket bond means coverage of potential claims aggregating not less than 50% of the total value of a prime contractor's home improvement contracts on a quarterly or semi-annual basis, or some other appropriate measure determined by regulation.

Comment. Subdivision (a) of Section 3244.20 makes clear that only a bond of a corporate surety is sufficient under this article See Code Civ. Proc. § 995.120 ("admitted surety insurer" defined); see generally Code Civ. Proc. § 995.010 *et seq.* (Bond and Undertaking Law). Subdivision (b) is necessary to negate the effect of Code of Civil Procedure Section 995.710 (deposit in lieu of bond permissible unless specific statute precludes deposit).

Subdivision (c) authorizes the use of a more efficient blanket payment bond, so long as the blanket payment bond affords equivalent coverage to the 50% payment bond described in Section 3244.10. The determination of standards for blanket payment bonds is delegated to the Contractors' State License Board. See Section 3244.70 (CSLB regulatory authority).

See also Sections 3095 ("payment bond" defined), ____ ("prime contractor" defined).

§ 3244.30. Limitation on owner's liability

3244.30. Whether or not the home improvement contract is filed and a payment bond is recorded as provided in Section 3244.10, the liability of an owner under a home improvement contract is limited to the contract price. Payments made to the prime contractor in good faith discharge the owner's liability to all claimants to the extent of the payments.

Comment. Section 3244.30 protects owners who, in good faith, pay the prime contractor according to the terms of a home improvement contract. This section is intended to shield owners from liability for double payment in cases where subcontractors and suppliers do not receive payments that have been made by the owner. Basic requirements governing good faith payments are provided in Section 3244.40.

See also Sections 3084 ("claim of lien" defined), 3085 ("claimant" defined), 3088 ("contract" defined), 3096 ("payment bond" defined), ____ ("prime contractor" defined), 3103 ("stop notice" defined).

§ 3244.40. Good faith payments

3244.40 (a) A payment is presumed to be made in good faith by the owner to the prime contractor if both of the following requirements are satisfied:

(1) The payment is made in a timely fashion pursuant to the applicable schedule of progress payments.

(2) At the time a payment is made, the owner has not received a notice of a claim by way of a timely claim of lien, stop notice, or direct pay notice.

(b) A claim of lien or stop notice is not timely within the meaning of subdivision (a) unless it is given by a claimant after the payment is in default under applicable

law. A direct pay notice is timely within the meaning of subdivision (a) if given in compliance with Section _____.

(c) Notwithstanding subdivisions (a) and (b), the owner may make payments in good faith if the amount remaining unpaid under the home improvement contract is sufficient to pay the claims of claimants other than the prime contractor of which the owner has received notice.

Comment. Section 3244.40 makes clear that the owner cannot make a good faith payment that would reduce the unpaid contract amount below the amount needed to pay claimant's who have given proper notice.

Subdivision (b) delineates the meaning of a timely communication to the owner that can defeat good faith payments. Unlike the general rule, lien claims and stop notices have no effect under this section unless given after payments to a claimant have become due and remain unpaid under governing statute and contract rules.

See also Sections 3084 ("claim of lien" defined), 3085 ("claimant" defined), 3088 ("contract" defined), 3096 ("payment bond" defined), ____ ("prime contractor" defined), 3103 ("stop notice" defined).

☞ **Staff Note.** Additional detail may be needed to flesh out subdivision (b). The staff will continue to work on this provision and implementation of the direct pay notice before the next meeting.

§ 3244.50. Enforcement of claims

3244.50. Except as provided in Section 3244.30, the mechanic's lien and stop notice rights of claimants are not limited by this article, and claimants may enforce payment by any remedy provided in this title, without the necessity of giving a preliminary 20-day notice.

Comment. Section 3244.40 makes clear that the only limitation on the rights of claimants is the rule protecting good faith owners from being subject to double liability for payments made under the contract. Thus, for example, subcontractors and suppliers may seek satisfaction from the owner as to amounts not yet paid to the prime contractor or from the construction lender by way of a stop notice. In addition, compensation may be sought from the payment bond. The final clause of this section emphasizes that the preliminary 20-day notice should not be used with regard to home improvement contracts. The notice is not necessary and serves to purpose in this context, and would be confusing to recipients. Sureties, lenders, and others may contract for notice as desired.

See also Sections 3084 ("claim of lien" defined), 3085 ("claimant" defined), 3103 ("stop notice" defined).

§ 3244.60. Penalty for noncompliance with bonding requirement

3244.60. The failure of a prime contractor to comply with the requirements of this article is a cause for disciplinary action by the Contractors' State License Board.

Comment. Section 3244.60 provides for discipline to enforce the bonding requirement in Section 3244.10.

See also Section ___ ("prime contractor" defined); Bus. & Prof. Code § 7000 *et seq.* (Contractors' State License Law).

§ 3244.70. Bond terms subject to regulation

3244.70. (a) The Contractors' State License Board shall, by regulation, provide standard terms for payment bonds required by this article, and shall set standards for blanket payment bonds satisfying the requirements of this article.

(b) The Contractors' State License Board shall, by regulation, provide the contents of the direct pay notice under Section _____.

Comment. Section 3244.70 grants regulatory authority to the Contractors' State License Board, to assist in carrying out the purpose of this article. This authority is consistent with the CSLB's special responsibility concerning home improvement contracts. See, e.g., Bus. & Prof. Code § 7150.2 (certification program, information pamphlets).

Uncodified (added). Operative date

SEC. ____. This act becomes operative on January 1, 2004, except that the authority granted the Contractors' State License Board to make regulations governing forms and notices, and any related implementing regulations, becomes operative on January 1, 2003.

Comment. This uncodified provision provides a one-year deferred operative date for the provisions in this act, other than the regulatory authority granted CSLB.

CONFORMING REVISIONS

BUSINESS AND PROFESSIONS CODE

Bus. & Prof. Code § 7018.5 (amended). Notice to owner

SEC. ____. Section 7018.5 of the Business and Professions Code Section is amended to read:

7018.5. (a) The board, by regulation, shall prescribe ~~a form~~ forms entitled "Notice to Owner (General)" and "Notice to Owner (Home Improvement)" or other appropriate titles, which shall ~~state~~: include the following information, in plain, nontechnical language:

(1) A description and summary of the rights and remedies of the parties to the contract.

(2) A description and summary of the rights and remedies of persons not in privity with the owner to whom the owner may be liable under the contract.

(3) Suggested procedures for the owner to ensure timely payment and to minimize the risk of double payment and avoidance of liens.

~~"Under the California Mechanics' Lien Law, any contractor, subcontractor, laborer, supplier, or other person or entity who helps to improve your property, but is not paid for his or her work or supplies, has a right to place a lien on your home, land, or property where the work was performed and to sue you in court to obtain payment.~~

~~This means that after a court hearing, your home, land, and property could be sold by a court officer and the proceeds of the sale used to satisfy what you owe. This can happen even if you have paid your contractor in full if the contractor's subcontractors, laborers, or suppliers remain unpaid.~~

~~To preserve their rights to file a claim or lien against your property, certain claimants such as subcontractors or material suppliers are each required to provide you with a document called a "Preliminary Notice." Contractors and laborers who contract with owners directly do not have to provide such notice since you are aware of their existence as an owner. A preliminary notice is not a lien against your property. Its purpose is to notify you of persons or entities that may have a right to file a lien against your property if they are not paid. In order to perfect their lien rights, a contractor, subcontractor, supplier, or laborer must file a mechanics' lien with the county recorder which then becomes a recorded lien against your property. Generally, the maximum time allowed for filing a mechanics' lien against your property is 90 days after substantial completion of your project.~~

~~TO INSURE EXTRA PROTECTION FOR YOURSELF AND YOUR PROPERTY, YOU MAY WISH TO TAKE ONE OR MORE OF THE FOLLOWING STEPS:~~

~~(1) Require that your contractor supply you with a payment and performance bond (not a license bond), which provides that the bonding company will either complete the project or pay damages up to the amount of the bond. This payment and performance bond as well as a copy of the construction contract should be filed with the county recorder for your further protection. The payment and performance bond will usually cost from 1 to 5 percent of the contract amount depending on the contractor's bonding ability. If a contractor cannot obtain such bonding, it may indicate his or her financial incapacity.~~

~~(2) Require that payments be made directly to subcontractors and material suppliers through a joint control. Funding services may be available, for a fee, in your area which will establish voucher or other means of payment to your contractor. These services may also provide you with lien waivers and other forms of protection. Any joint control agreement should include the addendum approved by the registrar.~~

~~(3) Issue joint checks for payment, made out to both your contractor and subcontractors or material suppliers involved in the project. The joint checks should be made payable to the persons or entities which send preliminary notices to you. Those persons or entities have indicated that they may have lien rights on your property, therefore you need to protect yourself. This will help to insure that all persons due payment are actually paid.~~

~~(4) Upon making payment on any completed phase of the project, and before making any further payments, require your contractor to provide you with unconditional "Waiver and Release" forms signed by each material supplier, subcontractor, and laborer involved in that portion of the work for which payment was made. The statutory lien releases are set forth in exact language in Section 3262 of the Civil Code. Most stationery stores will sell the "Waiver and Release" forms if your contractor does not have them. The material suppliers, subcontractors, and laborers that you obtain releases from are those persons or entities who have filed preliminary notices with you. If you are not certain of the material suppliers, subcontractors, and laborers working on your project, you may obtain a list from your contractor. On projects involving improvements to a single-family residence or a duplex owned by individuals, the persons signing these releases lose the right to file a mechanics' lien claim against your property. In other types of construction, this protection may still be important, but may not be as complete.~~

~~To protect yourself under this option, you must be certain that all material suppliers, subcontractors, and laborers have signed the "Waiver and Release" form. If a mechanics' lien has been filed against your property, it can only be voluntarily released by a recorded "Release of Mechanics' Lien" signed by the person or entity that filed the mechanics' lien against your property unless the lawsuit to enforce the lien was not timely filed. You should not make any final payments until any and all such liens are removed. You should consult an attorney if a lien is filed against your property."~~

(b) Each contractor licensed under this chapter, prior to entering into a contract with an owner for work specified as home improvement or swimming pool construction pursuant to Section 7159, shall give a copy of ~~this~~ the "Notice to Owner (Home Improvement)" to the owner, the owner's agent, or the payer. The failure to provide this notice as required ~~shall constitute~~ constitutes grounds for disciplinary action.

Comment. Section 7018.5 is amended to replace the explicit language of the Notice to Owner with authority for the Contractors State License Board to provide by regulation for appropriate notice language. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

☞ **Staff Note.** Additional items and some explicit language may be added to this section, as desired, without undermining the purpose of making the form more capable of responding to changing conditions.

Bus. & Prof. Code § 7159 (amended). Home improvement contract requirements

SEC. ____. Section 7159 of the Business and Professions Code Section is amended to read:

7159. (a) This section applies only to home improvement contracts, as defined in Section 7151.2, between a contractor, whether a general contractor or a specialty contractor, who is licensed or subject to be licensed pursuant to this chapter with regard to the transaction and who contracts with an owner or tenant for work upon a residential building or structure, or upon land adjacent thereto, for proposed repairing, remodeling, altering, converting, modernizing, or adding to the residential building or structure or land adjacent thereto, and where the aggregate contract price specified in one or more improvement contracts, including all labor, services, and materials to be furnished by the contractor, exceeds five hundred dollars ($500).

(b) Every home improvement contract and every contract, the primary purpose of which is the construction of a swimming pool, is subject to this section.

(c) Every contract and any changes in the contract subject to this section shall be evidenced by a writing and shall be signed by all the parties to the contract. The writing shall contain all of the following:

~~(a)~~

(1) The name, address, and license number of the contractor, and the name and registration number of any salesperson who solicited or negotiated the contract.

(2) The name and telephone number of the surety on the prime contractor's payment bond and, if available, an identification number for the bond.

~~(b)~~

(3) The approximate dates when the work will begin and on which all construction is to be completed.

~~(c)~~

(4) A plan and scale drawing showing the shape, size, dimensions, and construction and equipment specifications for a swimming pool and for other home improvements, a description of the work to be done and description of the

materials to be used and the equipment to be used or installed, and the agreed consideration for the work.

~~(d)~~

(5) A schedule of payments showing the amount of each payment as a sum in dollars and cents, subject to the following requirements:

(A) If the payment schedule contained in the contract provides for a downpayment to be paid to the contractor by the owner or the tenant before the commencement of work, the downpayment may not exceed two hundred dollars ($200) or 2 percent of the contract price for swimming pools, or one thousand dollars ($1,000) or 10 percent of the contract price for other home improvements, excluding finance charges, whichever is less.

~~(e) A schedule of payments showing the amount of each payment as a sum in dollars and cents.~~

(B) In no event may the payment schedule provide for the contractor to receive, nor may the contractor actually receive, payments in excess of 100 percent of the value of the work performed on the project at any time, excluding finance charges, except that the contractor may receive an initial downpayment authorized by ~~subdivision (d)~~ subparagraph (A). With respect to a swimming pool contract, the final payment may be made at the completion of the final plastering phase of construction, provided that any installation or construction of equipment, decking, or fencing required by the contract is also completed. A failure by the contractor without lawful excuse to substantially commence work within 20 days of the approximate date specified in the contract when work will begin shall postpone the next succeeding payment to the contractor for that period of time equivalent to the time between when substantial commencement was to have occurred and when it did occur. The schedule of payments shall be stated in dollars and cents, and shall be specifically referenced to the amount of work or services to be performed and to any materials and equipment to be supplied. With respect to a contract that provides for a schedule of monthly payments to be made by the owner or tenant and for a schedule of payments to be disbursed to the contractor by a person or entity to whom the contractor intends to assign the right to receive the owner's or tenant's monthly payments, the payments referred to in this subdivision mean the payments to be disbursed by the assignee and not those payments to be made by the owner or tenant.

~~(f)~~ (6) A statement that, upon satisfactory payment being made for any portion of the work performed, the contractor shall, prior to any further payment being made, furnish to the person contracting for the home improvement or swimming pool a full and unconditional release from any claim or mechanic's lien ~~pursuant to Section 3114 of the Civil Code~~ for that portion of the work for which payment has been made.

~~(g)~~ (7) The requirements set forth in ~~subdivisions (d), (e), and (f)~~ paragraphs (5) and (6) do not apply when the contract provides for the contractor to furnish a performance and payment bond, lien and completion bond, bond equivalent, or

joint control approved by the registrar covering full performance and completion of the contract and the bonds or joint control is or are furnished by the contractor, or when the parties agree for full payment to be made upon or for a schedule of payments to commence after satisfactory completion of the project.

(8) The contract shall contain, in close proximity to the signatures of the owner and contractor, a notice in at least 10-point type stating that the owner or tenant has the right to require the contractor to have a performance and payment bond.

(9) What constitutes substantial commencement of work pursuant to the contract.

(10) The language of the notice required pursuant to Section 7018.5.

(11) A notice that failure by the contractor without lawful excuse to substantially commence work within 20 days from the approximate date specified in the contract when work will begin is a violation of the Contractors' State License Law.

(12) Other matters agreed to by the parties to the contract.

(d) The writing shall be legible and shall be in a form that clearly describes any other document that is to be incorporated into the contract.

(e) Before any work is done, the owner shall be furnished a copy of the written agreement, signed by the contractor.

~~(h)~~

(f) No extra or change-order work may be required to be performed without prior written authorization of the person contracting for the construction of the home improvement or swimming pool. No change-order is enforceable against the person contracting for home improvement work or swimming pool construction unless it clearly sets forth the scope of work encompassed by the change-order and the price to be charged for the changes. Any change-order forms for changes or extra work shall be incorporated in, and become a part of, the contract. Failure to comply with the requirements of this subdivision does not preclude the recovery of compensation for work performed based upon quasi-contract, quantum meruit, restitution, or other similar legal or equitable remedies designed to prevent unjust enrichment.

~~(i)~~

(g) If the contract provides for a payment of a salesperson's commission out of the contract price, that payment shall be made on a pro rata basis in proportion to the schedule of payments made to the contractor by the disbursing party in accordance with subparagraph (B) of paragraph (5) of subdivision ~~(e)~~ (c).

~~(j) The language of the notice required pursuant to Section 7018.5.~~

~~(k) What constitutes substantial commencement of work pursuant to the contract.~~

~~(*l*) A notice that failure by the contractor without lawful excuse to substantially commence work within 20 days from the approximate date specified in the contract when work will begin is a violation of the Contractors' State License Law.~~

~~(m)~~

(h) If the contract provides for a contractor to furnish joint control, the contractor shall not have any financial or other interest in the joint control.

(i) A failure by the contractor without lawful excuse to substantially commence work within 20 days from the approximate date specified in the contract when work will begin is a violation of this section.

(j) This section does not prohibit the parties to a home improvement contract from agreeing to a contract or account subject to Chapter 1 (commencing with Section 1801) of Title 2 of Part 4 of Division 3 of the Civil Code.

~~The writing may also contain other matters agreed to by the parties to the contract.~~

~~The writing shall be legible and shall be in a form that clearly describes any other document that is to be incorporated into the contract. Before any work is done, the owner shall be furnished a copy of the written agreement, signed by the contractor.~~

~~For purposes of this section, the board shall, by regulation, determine what constitutes "without lawful excuse."~~

(k) The provisions of this section are not exclusive and do not relieve the contractor or any contract subject to it from compliance with all other applicable provisions of law.

(*l*) A violation of this section by a licensee, or a person subject to be licensed, under this chapter, or by his or her agent or salesperson, is a misdemeanor punishable by a fine of not less than one hundred dollars ($100) nor more than five thousand dollars ($5,000), or by imprisonment in the county jail not exceeding one year, or by both that fine and imprisonment.

~~(n)~~

(m) Any person who violates this section as part of a plan or scheme to defraud an owner of a residential or nonresidential structure, including a mobilehome or manufactured home, in connection with the offer or performance of repairs to the structure for damage caused by a natural disaster, shall be ordered by the court to make full restitution to the victim based on the person's ability to pay, as defined in subdivision (e) of Section 1203.1b of the Penal Code. In addition to full restitution, and imprisonment authorized by this section, the court may impose a fine of not less than five hundred dollars ($500) nor more than twenty-five thousand dollars ($25,000), based upon the defendant's ability to pay. This subdivision applies to natural disasters for which a state of emergency is proclaimed by the Governor pursuant to Section 8625 of the Government Code or for which an emergency or major disaster is declared by the President of the United States.

~~(*o*)~~

(n)(1) An indictment or information against a person who is not licensed, but who is required to be licensed under this chapter, shall be brought, or a criminal

complaint filed, for a violation of this section within four years from the date the buyer signs the contract.

(2) An indictment or information against a person who is licensed under this chapter shall be brought, or a criminal complaint filed, for a violation of this section within one year from the date the buyer signs the contract.

(3) The limitations on actions in this subdivision ~~shall~~ do not apply to any administrative action filed against a licensed contractor.

(*o*) For purposes of this section, the board shall, by regulation, determine what constitutes "without lawful excuse."

Comment. Section 7159 is amended to separate the provisions governing the contents of a home improvement contract from substantive rules concerning duties, liabilities, and other matters, to group the provisions in a more logical order, and to supply subdivision designations for floating paragraphs. These revisions are technical, nonsubstantive changes.

The required contents of a home improvement contract are set out in subdivision (c), which continues without substantive change the material formerly in subdivisions (a)-(g) and (j)-(*l*), part of the second paragraph, and the third paragraph following former subdivision (m). The reference in subdivision (c)(2) to identifying information relating to payment bonds is intended to facilitate the home improvement contract payment bond requirements in Civil Code Section 3244 *et seq.*

The reference in former subdivision (f) (now subdivision (c)(6)) to Civil Code Section 3114 has been deleted because it was incorrect. Omitting this language has no effect on the substance of this provision. When the cross-reference was enacted in 1979, it described a person, other than the contractor, who was entitled under Civil Code Section 3114 to enforce a mechanic's lien. See former Bus. & Prof. Code § 7167, as enacted by 1979 Cal. Stat. ch. 747, § 2. The cross-reference was incorporated into Section 7159 in 1991, but in a form that corrupted the original purpose. See 1991 Cal. Stat. ch. 1160, § 45 (amending Section 7159), § 50 (repealing former Section 7167).

☞ **Staff Note.** More could and should be done with this section. It should be divided into a number of shorter sections addressing discrete topics.

There may be other provisions in the Contractors' State License Law (Bus. & Prof. Code §§ 7000-7191) that will need to be conformed.

Bus. & Prof. Code § 7167 (technical amendment). Contracts for swimming pools

SEC. ____. Section 7167 of the Business and Professions Code is amended to read:

7167. ~~Any~~ A contract ~~the~~ whose primary purpose ~~of which~~ is the construction of a swimming pool ~~which~~ and that does not substantially comply with the applicable provisions of ~~subdivisions (b), (c), (d), (e), (f), and (h)~~ paragraphs (2), (4), (5), and (6) of subdivision (c), and subdivision (f), of Section 7159, ~~shall be~~ is void and unenforceable by the contractor as contrary to public policy.

Comment. Section 7167 is amended to revise subdivision references to reflect renumbering of parts of Section 7159. These are technical, nonsubstantive changes See Section 7159 Comment.

CIVIL CODE

Civ. Code § 3097 (amended). Preliminary 20-day notice (private work)

SEC. ____. Section 3097 of the Civil Code is amended to read:

3097. "Preliminary 20-day notice (private work)" means a written notice from a claimant that is given prior to the recording of a mechanic's lien, prior to the filing of a stop notice, and prior to asserting a claim against a payment bond, and is required to be given under the following circumstances:

(a) Except one under direct contract with the owner or one performing actual labor for wages as described in subdivision (a) of Section 3089, or a person or entity to whom a portion of a laborer's compensation is paid as described in subdivision (b) of Section 3089, or as provided in subdivision (q), every person who furnishes labor, service, equipment, or material for which a lien or payment bond otherwise can be claimed under this title, or for which a notice to withhold can otherwise be given under this title, shall, as a necessary prerequisite to the validity of any claim of lien, payment bond, and of a notice to withhold, cause to be given to the owner or reputed owner, to the original contractor, or reputed contractor, and to the construction lender, if any, or to the reputed construction lender, if any, a written preliminary notice as prescribed by this section.

(b) Except the contractor, or one performing actual labor for wages as described in subdivision (a) of Section 3089, or a person or entity to whom a portion of a laborer's compensation is paid as described in subdivision (b) of Section 3089, or as provided in subdivision (q), all persons who have a direct contract with the owner and who furnish labor, service, equipment, or material for which a lien or payment bond otherwise can be claimed under this title, or for which a notice to withhold can otherwise be given under this title, shall, as a necessary prerequisite to the validity of any claim of lien, claim on a payment bond, and of a notice to withhold, cause to be given to the construction lender, if any, or to the reputed construction lender, if any, a written preliminary notice as prescribed by this section.

….

[**Staff Note.** Subdivisions (c)-(p) — 2,424 words — have been omitted to save paper. See Memorandum 2001-71 for proposed general revision of Section 3097.]

….

(q) As provided in Chapter 6 (commencing with Section 3235),this section does not apply to home improvement contracts.

Comment. Section 3097 is amended, and subdivision (q) is added, to recognize the exception to the general preliminary notice requirement provided in Section 3244.40 (home improvement contracts).

See also Sections 3083 ("bonded stop notice" defined), 3085 ("claimant" defined), 3084 ("claim of lien" defined), 3089 ("laborer" defined), 3087 ("construction lender" defined), 3090 ("materialman" defined), 3095 ("original contractor" defined), 3096 ("payment bond" defined), 3103 ("stop notice" defined), 3104 ("subcontractor" defined), 3106 ("work of improvement" defined).

☞ **Staff Note.** Like Business and Professions Code Section 7159, Civil Code Section 3097 needs to be broken up into many shorter sections and reorganized in the course of the general revision.

Civ. Code § 3114 (amended). Preliminary notice required

SEC. ____. Section 3114 of the Civil Code is amended to read:

3114. ~~A~~ Except as provided in Section 3244.40, a claimant ~~shall be~~ is entitled to enforce a lien only if ~~he has given the~~ a preliminary 20-day notice (private work) has been given in accordance with ~~the provisions of~~ Section 3097, if required by that section, and has made proof of service in accordance with ~~the provisions of~~ Section 3097.1.

Comment. Section 3114 is amended to recognize the exception to the lien enforcement right provided in Section 3244.40 (home improvement contracts). The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3085 ("claimant" defined), 3097 ("preliminary 20-day notice (private work)" defined).

Civ. Code § 3123 (amended). Direct lien, amount of lien

SEC. ____. Section 3123 of the Civil Code is amended to read:

3123. (a) The liens provided for in this chapter ~~shall be~~ are direct liens~~,~~ and shall be for the reasonable value of the labor, services, equipment, or materials furnished or for the price agreed upon by the claimant and the person with whom ~~he or she~~ the claimant contracted, whichever is less. The lien ~~shall~~ is not ~~be~~ limited ~~in amount~~ by the price stated in the contract~~, as defined in Section 3088~~ between the owner and the original contractor, except as provided in ~~Sections 3235 and 3236 and in~~ [subdivision (c) of this section and in] Chapter 6 (commencing with Section 3235).

(b) This section does not preclude the claimant from including in the lien any amount due for labor, services, equipment, or materials furnished based on a written modification of the contract or as a result of the rescission, abandonment, or breach of the contract. However, in the event of rescission, abandonment, or breach of the contract, the amount of the lien may not exceed the reasonable value of the labor, services, equipment, and materials furnished by the claimant.

(c) The owner shall notify the prime contractor and construction lenders of any changes in the contract if the change has the effect of increasing the price stated in the contract by 5 percent or more.

Comment. Subdivision (a) of Section 3123 is amended to recognize the limitations applicable to home improvement contracts under Article 3 (commencing with Section 3244) of Chapter 6. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Section 3085 ("claimant" defined), 3087 ("construction lender" defined).

☞ **Staff Note.** The *Roystone* majority was puzzled by the "direct lien" language, noting parenthetically "whatever that may mean." Roystone Co. v. Darling. 171 Cal. 526, 537 (1915). The language probably serves no purpose now, but was arguably important to signal the change in the law brought about by the 1911 amendments.

Note the use of "prime contractor" in subdivision (c). As a general matter, the Commission has tentatively decided to replace "original contractor" with "prime contractor" throughout the statute

in the course of a general revision. But if that revision does not take place, it might be best to replace "prime" with "original" in this section.

Note also the 5% figure in subdivision (c). The staff is proposing that an increased bond in the home improvement contract area be required if the price is increased by 10%. See draft Section 3244.10(b)-(c) *supra.*

It is not readily apparent to the staff why subdivision (c) is considered to be an exception to the direct lien rule in subdivision (a). Subdivision (c) on its face simply provides a notice right when change orders increase the contract price. This provision should be given further study to make its meaning clear. Subdivision (c) is misplaced and by its terms has little or nothing to do with the rest of the section.

Civ. Code § 3159 (amended). Duties of construction lender with regard to stop notice

SEC. ____. Section 3159 of the Civil Code is amended to read:

3159. (a) ~~Any of the persons named~~ A claimant described in ~~Sections~~ Section 3110, 3111, ~~and~~ or 3112 may, prior to the expiration of the period within which ~~his or her~~ the claim of lien ~~must~~ is required to be recorded under Chapter 2 (commencing with Section 3109), [~~give~~ deliver] to a construction lender a stop notice or a bonded stop notice. The construction lender ~~shall be~~ is subject to the following duties:

(1) The construction lender shall withhold funds pursuant to a bonded stop notice [filed] by an original contractor, regardless of whether a payment bond has previously been recorded ~~in the office of the county recorder where the site is located in accordance with Section 3235~~ pursuant to Chapter 6 (commencing with Section 3235).

(2) The construction lender shall withhold funds pursuant to a bonded stop notice [filed] by ~~any other person named in~~ ~~Sections~~ a claimant described in Section 3110, 3111, ~~and~~ or 3112, other than an original contractor, unless a payment bond has previously been recorded ~~in the office of the county recorder where the site is located in accordance with Section 3235~~ pursuant to Chapter 6 (commencing with Section 3235). If a payment bond has previously been recorded, the construction lender may, at its option, withhold funds pursuant to the ~~bonded~~ stop notice or bonded stop notice, or may elect not to withhold pursuant to the ~~bonded~~ stop notice or bonded stop notice [given] by anyone other than an original contractor.

(3) If, when [giving] the construction lender the stop notice or bonded stop notice, the claimant makes a written request for notice of the election, accompanied by a preaddressed, stamped envelope, the construction lender shall [furnish] the claimant a copy of the bond within 30 days after making the election. A lender ~~shall~~ is not ~~be~~ liable for a failure to [furnish] a copy of the bond if the failure was not intentional and resulted from a ~~bona fide~~ good faith error, if the lender maintains reasonable procedures to avoid ~~such an~~ this type of error, and if the error was corrected not later than 20 days from the date on which the violation was discovered. The payment bond may be recorded at any time prior to ~~the serving~~ [service] of the first stop notice. The notice may only be [given] for materials, equipment, or services furnished, or labor performed.

(b) In the case of a stop notice or bonded stop notice [filed] by the original contractor or by a subcontractor, the original contractor or subcontractor ~~shall~~ is only ~~be~~ entitled to recover on his or her stop notice or bonded stop notice the net amount due the original contractor or subcontractor after deducting the stop notice claims of all subcontractors or material suppliers who have [filed] bonded stop notices on account of work done on behalf of the original contractor or the subcontractor.

(c) In no event ~~shall~~ is the construction lender ~~be~~ required to withhold, pursuant to a bonded stop notice, more than the net amount identified in subdivision (b). Notwithstanding any other provision, ~~no~~ a construction lender ~~shall have any liability~~ is not liable for the failure to withhold more than this net amount upon receipt of a bonded stop notice.

Comment. Section 3159 is amended to recognize the bonding requirement applicable to home improvement contracts under Section 3244.10. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3083 ("bonded stop notice" defined), 3085 ("claimant" defined), 3087 ("construction lender" defined), 3090 ("materialman" defined), 3095 ("original contractor" defined), 3096 ("payment bond" defined), 3103 ("stop notice" defined), 3104 ("subcontractor" defined).

☞ **Staff Note.** The statute uses "stop notice" to mean (1) both bonded and unbonded stop notices, as in this section, and (2)only unbonded stop notices, as in Section 3159. This is troublesome in a number of sections, such as Section 3162(b) below. As a general revision, the staff proposes to replace the phrase "stop notice or bonded stop notice" with "top notice" and use the term "unbonded stop notice" in the rare case where the statute intends to draw a distinction.

This section is *identical* to Section 3162, except for the different wording of the first sentence of subdivision (a) and the last sentence of subdivision (a)(3), which does not appear in Section 3162. This confusing and pointless repetition should be fixed by way of a general revision of the mechanic's lien statute.

The statutes are not consistent in using "file," "give," and "serve" to refer to the same actions. This should be fixed in the general revision. See the language in brackets in Section 3159. "File" should only be used when a paper is filed with an official having a duty to accept it. "Deliver" should be used unless formal service is required. "Give" is generally considered to be too informal.

The preferred term is "good faith" instead of "bona fide." In existing law, "good faith" is used in seven sections (3097(*o*)(3), 3137, 3145, 3236, 3260.1(b), 3262.5(a), 3263) and "bona fide" is used in five sections (3159(a)(3), 3162(a)(3), 3260(e), 3261, 3262).

Civ. Code § 3160 (amended). Effective service of stop notice

SEC. ____. Section 3160 of the Civil Code is amended to read:

3160. [Service] of a stop notice or a bonded stop notice ~~shall be~~ is effective only if the claimant has satisfied both of the following requirements:

(a) [Gave] the preliminary 20-day notice (private work) in accordance with ~~the provisions of~~ Section 3097, if required by that section~~; and~~ or any other provision in this title.

(b) [Served] ~~his~~ the stop notice ~~as defined in Section 3103 or his~~ or bonded stop notice ~~as defined in Section 3083~~ prior to the expiration of the period within which

~~his~~ a claim of lien ~~must~~ is required to be recorded under Section 3115, 3116, or 3117.

Comment. Subdivision (a) of Section 3160 is amended to recognize that other provisions may excuse the duty to file a preliminary 20-day notice, specifically Section 3244.40, relating to home improvement contracts. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3083 ("bonded stop notice" defined), 3085 ("claimant" defined), 3097 ("preliminary 20-day notice (private work)" defined), 3103 ("stop notice" defined), 3104 ("subcontractor" defined).

☞ **Staff Note.** As to the cross reference in subdivision (b), note that Section 3159(a) refers to "recorded under Chapter 2 (commencing with Section 3109)" rather than "recorded under Section 3115, 3116, or 3117." It does not appear that any special distinction or limitation is intended by the language in subdivision (b). The broader reference is probably preferable, to avoid technical problems if a relevant section were to be added and a cross-reference is not added to subdivision (b).

Civ. Code § 3161 (amended). Withholding by owner in response to stop notice

SEC. ____. Section 3161 of the Civil Code is amended to read:

3161. ~~It shall be the duty of the owner upon~~ (a) Upon receipt of a stop notice pursuant to Section 3158 ~~to~~, the owner shall withhold from the original contractor or from any person acting under his or her authority and to whom labor or materials, or both, have been furnished, or agreed to be furnished, sufficient money due or to become due to ~~such~~ the original contractor to answer [such claim and any claim of lien that may be recorded therefor], unless a payment bond has been recorded pursuant ~~to the provisions of Section 3235~~ Chapter 6 (commencing with Section 3235), in which case the owner may, but is not obligated to, withhold ~~such~~ the money.

(b) If the owner elects not to withhold pursuant to a stop notice by reason of a payment bond having been previously recorded, then the owner shall, within 30 days after receipt of the stop notice, give a written notice to the claimant at the address shown in the stop notice that the bond has been recorded and furnish to the claimant a copy of that bond.

Comment. Section 3161 is amended to recognize the bonding requirement applicable to home improvement contracts under Section 3244.10. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3085 ("claimant" defined), 3095 ("original contractor" defined), 3097 ("preliminary 20-day notice (private work)" defined), 3103 ("stop notice" defined),

☞ **Staff Note.** In the first paragraph, the antecedent to "any person acting under his or her authority" is not clear. Note also that only labor and materials are mentioned — what about equipment and services? Compare Sections 3159(b) ("materials, equipment, or services furnished, or labor performed"), 3168 ("labor, services, equipment, or materials").

Civ. Code § 3162 (amended). Withholding by lenders

SEC. ____. Section 3162 of the Civil Code is amended to read:

3162. (a) ~~Upon~~ Except as otherwise provided in this section, upon receipt of ~~a~~ an unbonded stop notice pursuant to Section 3159, the construction lender may, and

upon receipt of a bonded stop notice the construction lender shall, ~~except as provided in this section,~~ withhold from the borrower or other person to whom ~~it~~ the construction lender or the owner may be obligated to make payments or advancement out of the construction fund, sufficient money to answer the claim [and any claim of lien that may be recorded therefor]. The construction lender ~~shall be~~ is subject to the following duties:

(1) The construction lender shall withhold funds pursuant to a bonded stop notice filed by an original contractor, regardless of whether a payment bond has previously been recorded ~~in the office of the county recorder where the site is located in accordance with Section 3235~~ pursuant to Chapter 6 (commencing with Section 3235).

(2) The construction lender shall withhold funds pursuant to a bonded stop notice filed by ~~any other person named in Sections~~ a claimant described in Section 3110, 3111, ~~and~~ or 3112, other than an original contractor, unless a payment bond has previously been recorded ~~in the office of the county recorder where the site is located in accordance with Section 3235~~ pursuant to Chapter 6 (commencing with Section 3235). If a payment bond has previously been recorded, the construction lender may, at its option, withhold funds pursuant to the ~~bonded~~ stop notice or bonded stop notice, or may elect not to withhold pursuant to the ~~bonded~~ stop notice or bonded stop notice given by anyone other than an original contractor.

(3) If, when giving the construction lender the stop notice or bonded stop notice, the claimant makes a written request for notice of the election, accompanied by a preaddressed, stamped envelope, the construction lender shall furnish the claimant a copy of the bond within 30 days after making the election. A lender ~~shall~~ is not ~~be~~ liable for a failure to furnish a copy of the bond if the failure was not intentional and resulted from a ~~bona fide~~ good faith error, if the lender maintains reasonable procedures to avoid ~~such an~~ this type of error, and if the error was corrected not later than 20 days from the date on which the violation was discovered. The payment bond may be recorded at any time prior to the serving of the first stop notice.

(b) In the case of a stop notice or bonded stop notice filed by the original contractor or by a subcontractor, the original contractor or subcontractor shall only be entitled to recover on his or her stop notice or bonded stop notice the net amount due the original contractor or subcontractor after deducting the stop notice claims of all subcontractors or material suppliers who have filed bonded stop notices on account of work done on behalf of the original contractor or the subcontractor.

(c) In no event ~~shall~~ is the construction lender ~~be~~ required to withhold, pursuant to a bonded stop notice, more than the net amount identified in subdivision (b) Notwithstanding any other provision, ~~no~~ a construction lender ~~shall have any liability~~ is not liable for the failure to withhold more than this net amount upon receipt of a bonded stop notice.

Comment. Section 3162 is amended to recognize the bonding requirement applicable to home improvement contracts under Section 3244.10. The other revisions are technical, nonsubstantive changes intended to improve clarity and modernize language.

See also Sections 3083 ("bonded stop notice" defined), 3085 ("claimant" defined), 3087 ("construction lender" defined), 3090 ("materialman" defined), 3095 ("original contractor" defined), 3096 ("payment bond" defined), 3103 ("stop notice" defined), 3104 ("subcontractor" defined).

☞ **Staff Note.** This section is *identical* to Section 3159, except for the different wording of the first sentence of subdivision (a) and the last sentence of Section 3159(a)(3), which does not appear in this section. This confusing and pointless repetition would be fixed in the proposed general revision of the mechanic's lien statute. See Memorandum 2001-71.
