Study H-820 January 15, 2002

Memorandum 2002-8

Mechanic's Liens: Report to Legislature (Staff Draft)

Attached to this memorandum is a staff draft of a Preliminary Report on *Mechanic's Lien Law Reform*. We have assigned the "preliminary" designation because more work needs to be done before the report is finalized and approved to print. But we want to be able to give a substantially comprehensive report to the Assembly Judiciary Committee as the 2002 legislative year gets underway.

Last summer it still looked like we might be able to produce at least a preliminary redraft of the whole mechanic's lien statute (Civ. Code §§ 3082-3267) and related provisions. However, work on the double liability problem has continued to consume most of the time allocated to mechanic's liens and initial forays into the details of the general revision suggested that there are hundreds if not thousands of knotty problems buried in this archaic, convoluted statute. Hence, at the November 15 meeting in Los Angeles, the Commission decided that the general revision should proceed at a working group level before the draft statute is brought back to the Commission.

In light of these circumstances, the report to the Assembly Judiciary Committee cannot include a comprehensive revision of the mechanic's lien law. The staff would like to continue editorial work on the preliminary report, if that is acceptable to the Commission, and forward it to the Committee after the January meeting. Then at some appropriate time in the future, the preliminary report can be supplemented or superseded by a report on the comprehensive revision of the mechanic's lien law.

Respectfully submitted,

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#H-820

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

Staff Draft PRELIMINARY REPORT

Mechanic's Lien Law Reform

January 2002

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SUMMARY OF PRELIMINARY REPORT

This report provides an overview of the Law Revision Commission's study of mechanic's lien law, emphasizing the pros and cons of proposals to address problems arising in home improvement contracts and the double liability problem.

The Commission also concludes that a thorough review and revision of the mechanic's lien law (Civ. Code §§ 3082-3267) and related provisions, including parts of the Contractors' State License Law (Bus. & Prof. Code §§ 7000-7191), should undertaken in order to modernize, simplify, and clarify the law, making it more user-friendly and effective.

This report was prepared pursuant to Resolution Chapter 78 of the Statutes of 2001.

MECHANIC'S LIEN LAW REFORM

Contents

SCOPE AND STATUS OF STUDY

Most of the Commission's study of mechanic's lien issues to date has been devoted to the double liability problem faced by homeowners whose prime contractors have failed to pay subcontractors and suppliers. Preliminary work has also been done on redrafting the mechanic's lien law[1] and related provisions in the Contractors' State License Law.[2] The Commission has been focusing on

1. The mechanic's lien is governed by Civil Code Sections 3082-3267. Generally speaking, and as used in this report, "mechanic's lien law" should be taken to include stop notice rights and bond remedies, which are all governed by Title 15 (commencing with Section 3082).

2. See Bus. & Prof. Code §§ 7000-7191.

mechanic's liens in the home improvement area because of the particular legislative interest in this subject in recent years[3] and because public discussions naturally gravitated to this important concern.

The Commission commenced its consideration of the mechanic's lien laws in response to a request from the Assembly Judiciary Committee to undertake a "comprehensive review of this area of the law, making suggestions for possible areas of reform and aiding the review of such proposals in future legislative sessions."[4] The Commission has preexisting authority from the Legislature to study this matter 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.[5]

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3. See ACA 5 (Honda) and AB 742 (Honda) in the 1999-2000 Session; AB 568 (Dutra), as introduced and as amended March 27, 2001, and AB 543 (Vargas), as amended April 16, 2001, in the 2001-2002 Session. Both AB 568 and 543 were amended in the Assembly on May 2, 2001, to remove the substantive provisions and add the following intent language:

> It is the intent of the Legislature to revise and reorganize the mechanics' lien and stop notice provisions in Title 15 (commencing with Section 3082) of Part 4 of Division 3 of the Civil Code, and related provisions, with the purpose of modernizing and simplifying the statutes and addressing problems, such as the potential for double payment by homeowners.

The Assembly Committee staff analysis of AB 568, as amended March 27, 2001, includes the following commentary:

> This bill, as proposed to be amended, sets forth a statement of legislative intent regarding the need for revisions of the law governing mechanic's liens and related provisions. As discussed below, the author agreed to amend the bill into legislative intent language at this time in order to create a potential vehicle for related *recommendations that are expected to come later this session from the California Law Revision Commission* (CLRC or Commission).
>
> Procedural History. The introduced version of this bill contained various provisions designed to address problems with mechanic's liens in the home improvement area, and included a homeowner's relief recovery fund. On March 27, 2001, the bill was amended to delete those provisions and replace them with a joint check approach to the problem.
>
> At the request of the Chair, the author agreed to delete the current contents of the bill and replace them with the legislative intent language set out above, in order *to serve as a vehicle for recommendations on the subject that are expected to be issued later this year by CLRC*. The author also agreed to bring the bill back to this Committee for further hearing at such time that substantive provisions are added to the measure.
>
> Pending CLRC Study of Mechanic's Lien Laws. On June 28, 1999, the then chair and vice-chair of this Committee sent a letter to CLRC requesting the Commission to undertake a "comprehensive review of [the law in the area of mechanic's liens and related provisions], including making suggestions for possible areas of reform and aiding the review of such proposals in future legislative sessions." The Commission is currently conducting this study. While its initial focus has been mechanic's liens in the home improvement area, given the particular interest in this subject during the last legislative session, the study is not limited to home improvement contracts. As CLRC has indicated, the entire mechanic's lien statute is ripe for revision and reorganization. (See CLRC Staff Memorandum 2001-18, "Mechanic's Liens: Overview of Reform Proposals," at p. 2 (Jan. 24, 2001).)

[Italic emphasis added.] The analysis of AB 543 contains similar language. Both of these bills passed the Assembly and are pending in the Senate.

4. See Letter from Assembly Members Sheila James Kuehl (Chair) and Rod Pacheco (Vice Chair), to Nat Sterling, June 28, 1999 (attached to Commission Staff Memorandum 99-85 (Nov. 16, 1999)).

5. For the text of the most recent legislative authorization, see 2001 Cal. Stat. res. ch. 78, set out as Appendix 2 to the *2001-2002 Annual Report*, 31 Cal. L. Revision Comm'n Reports 1, at ___ (2001).

This preliminary report summarizes the main points of discussion in past Commission meetings, and provides references to Commission meeting materials where additional detail may be found, particularly the valuable comments received from Commission consultants, meeting participants, and others who sent letters and email.

The following is a complete list of mechanic's lien memorandums (Study H-820) to date:[6]

Memo	*Supp*	*Title*	*Date*
99-85		Mechanic's Liens: Commencement of Study	11/16/99
99-85	1st	Mechanic's Liens: Commencement of Study (Additional Material)	11/29/99
2000-9		Mechanic's Liens	1/31/00
2000-9	1st	Mechanic's Liens: Update on HIPP Project	1/31/00
2000-9	2d	Mechanic's Liens (Materials Submitted at February 2000 Meeting)	2/11/00
2000-26		Mechanic's Liens: Issues and Other Approaches	4/04/00
2000-26	1st	Mechanic's Liens (Comments of Gordon Hunt)	4/10/00
2000-26	2d	Mechanic's Liens (Materials Submitted at April 2000 Meeting)	4/13/00
2000-36		Mechanic's Liens: Constitutional Issues	6/02/00
2000-36	1st	Mechanic's Liens: Constitutional Issues (Abdulaziz Letter)	6/15/00
2000-37		Mechanic's Liens: Draft Proposals	6/13/00
2000-37	1st	Mechanic's Liens (Letters)	6/16/00
2000-37	2d	Mechanic's Liens (Materials Submitted at June 2000 Meeting)	6/22/00
2000-47		Mechanic's Liens: Full Pay and Direct Pay Drafts	7/14/00
2000-47	1st	Mechanic's Liens (Additional Comments)	7/18/00
2000-63		Mechanic's Liens: Home Improvement Payment Bond	9/29/00
2000-63	1st	Mechanic's Liens (Commentary from Consultants)	10/02/00
2000-63	2d	Mechanic's Liens (Additional Commentary)	10/03/00
2000-78		Mechanic's Liens: Reform Proposals	12/06/00
2000-78	1st	Mechanic's Liens (General Comment Letters)	12/06/00
2000-78	2d	Mechanic's Liens (Homeowner's Recovery Fund)	12/08/00
2000-78	3d	Mechanic's Liens: Homeowner's Relief Recovery Act (New Draft)	12/08/00
2000-78	4th	Mechanic's Liens (More Comment Letters)	12/13/00
2000-78	5th	Mechanic's Liens (More Comment Letters)	12/14/00
2001-18		Mechanic's Liens: Overview of Reform Proposals	1/24/01
2001-18	1st	Mechanic's Liens: Homeowners' Relief Recovery Fund	1/24/01
2001-18	2d	Mechanic's Liens (Comment Letters)	1/30/01
2001-41		Mechanic's Liens: General Revision	5/10/01
2001-41	1st	Mechanic's Liens: General Revision (Comments of Gordon Hunt)	5/11/01
2001-41	2d	Mechanic's Liens: General Revision (Comments of Sam Abdulaziz & James Acret)	5/16/01
2001-52		Mechanic's Liens: Double Payment Issue	6/19/01
2001-52	1st	Mechanic's Liens: Double Payment Issue (Commentary)	6/26/01
2001-52	2d	Mechanic's Liens: Double Payment Issue (Commentary)	6/28/01
2001-53		Mechanic's Liens: General Statutory Revision	6/21/01

6. In the following discussion, we will refer to these materials using the following format: "Memo 2000-26 pp. 3-4" for pages in a memorandum, "Memo 2000-26 Ex. pp. 1-2" for pages in an exhibit, and "Memo 2000-26 Supp. 2 p. 1" for pages in a supplement. Other variations are possible, as when separately paged materials are attached to memos (e.g., Gordon Hunt's reports).

2001-53	1st	Mechanic's Liens: General Statutory Revision (Commentary)	6/26/01
2001-70		Mechanic's Liens: Double Payment Issue (Draft Tentative Recommendation)	9/11/01
2001-70	1st	Mechanic's Liens: Double Payment Issue (Commentary)	9/19/01
2001-71		Mechanic's Liens: General Revision	9/17/01
2001-92		Mechanic's Liens: General Revision	11/07/01
2001-92	1st	Mechanic's Liens: General Revision (Abdulaziz Comments)	11/13/01
2001-99		Mechanic's Liens: Double Payment (Comments on Tentative Recommendation)	11/21/01
2001-99	1st	Mechanic's Liens: Double Payment (CSLB Bond Report)	11/26/01
2001-99	2d	Mechanic's Liens: Double Payment (Additional Commentary)	11/29/01
2002-7		Mechanic's Liens: Double Payment Issue (Comments on Discussion Draft)	1/14/02
2002-7	1st	Mechanic's Liens: Double Payment Issue (Comments on Discussion Draft)	1/16/02

ADDRESSING THE DOUBLE LIABILITY PROBLEM

The following discussion summarizes the various proposals that have come before the Commission in its consideration of the double liability problem. The Commission's recommendation for addressing this issue as to certain home improvement contracts is set out in a separate recommendation on *The Double Liability Problem in Home Improvement Contracts* (January 2002).[7]

Incremental Reforms

Many commentators have argued either that the law is fine or that only some minor adjustments would be needed to address specific problems that are identified. From this perspective, the existing statute has reached a state of balance through its constant amendment over the years (although it is generally admitted that the statutory language and organization are confusing). The best approach, then, might be to consider just one or more incremental reforms to make the fine adjustments needed to address specific issues and further tune the statutory balance. Major changes would be disruptive and destroy the balance that has resulted from 90 years of amendments and recodification since the direct lien was enacted. But regardless of whether it is concluded that more dramatic reforms are needed, one or more of these incremental reforms may also be appropriate as part of an overall reform package.

Better Notice

In home improvement contracts, Business and Professions Code Section 7018.5 requires the prime contractor to give a special notice to the homeowner ("Notice to Owner"). The existing mechanic's lien system depends critically on the

7. This recommendation follows a Tentative Recommendation on *The Double Payment Problem in Home Improvement Contracts* (September 2001) and a Discussion Draft on *Consumer Protection Options Under Home Improvement Contracts* (December 2001).

preliminary 20-day notice given to the owner (and others) by potential lien claimants, as prescribed by Civil Code Section 3097. Ideally, these notices would enlighten all but the densest homeowners, who would then act intelligently, based on the instructions in the form, to protect their interests sensibly and cheaply through the best available remedy. It is generally recognized that the existing notices do not facilitate this result. Whether any form can do so is doubtful when the underlying law is as complex and convoluted as the mechanic's lien statute. But it is worth the effort to make whatever notices appear in the law clearer and more direct, even if the improvements may be marginal. Statutory notices are usually troublesome, becoming stale because of the burden of amending the statute to make revisions. To the extent possible, the specific content of notices should be left to regulation.

A number of suggestions for ways to improve the notices are in set out in Commission meeting materials.[8]

One improved notice scheme, based in part on the CSLB's proposed Home Improvement Protection Plan ("HIPP 2000"), would (1) change the name of the "Notice to Owner" given by the prime contractor at the start of a project to "Mechanic's Lien Warning," (2) require the prime contractor to obtain written confirmation from the owner that the warning had been received, (3) make failure to give the notice and get confirmation a violation of the Contractors' State License Law, subjecting the prime contractor to discipline, (4) make injuries arising out of the failure to give the warning compensable from the license bond, and (5) include a checklist to assist the owner in determining whether all important steps had been taken.[9] Requiring confirmation may help in some cases, and addresses the issue raised in CSLB correspondence concerning whether the prime contractor bothers to give the required notice. But common experience with signing preprinted forms suggests that the confirmation may end up being just another piece of paper to be signed with other items.

Pros. Notice and consumer education are desirable as a cheap and efficient way to avoid problems up front. If homeowners are adequately informed of their rights and remedies under the law, and the law is fair, then they can look out for their interests without the need for additional complications and added expense of mandating new procedures on everyone. The Contractors State License Board has the authority and responsibility to protect homeowners and is in a position to improve notices and educate homeowners and contractors.

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8. See Memo 2000-9, Hunt Report Pt. 2 Ex. pp. 32-40 (CSLB's HIPP 2000 draft of Aug. 1999); Memo 2000-9 Supp. 1 (CSLB revised HIPP draft of Jan. 2000); Memo 2000-37 p. 6, & Ex. pp. 9-17 (Abdulaziz drafts); Memo 2000-47 Supp. 2 Ex. pp. 23-32 (Abdulaziz drafts) & Ex. pp. 33-37 (staff versions). For release forms, see Memo 99-85, Hunt Report Pt. 1, Ex. pp. 12-19; release forms are discussed, e.g., in Memo 99-85, Hunt Report Pt. 1 pp. 13-16l Memo 2000-37 Ex. pp. 22-23 (Gallagher); Memo 2000-78 Ex. pp. 1-2 (Acret). See also Memo 2000-37 Supp. 2 pp. 3-4 (LACN).

9. See Memo 2000-37 Ex. pp. 9-17 (Abdulaziz drafts).

Cons. It is unrealistic to think that notice alone is a sufficient answer to the problems under discussion. The law is too complex to be described briefly and understandably. Those who have tried to rewrite the existing notices have been generally pessimistic about the result. Even if it were possible, notice alone does not overcome the trouble and expense of deciding what steps to take, particularly where common sense dictates that an owner who progress payments as they come due has fulfilled the contractual obligation. Few homeowners, particularly on smaller projects, would be likely to bother with bonding or joint control agencies, even if they understood how to go about it.

Increased License Bond

The contractor's license bond could be increased to a level that would provide more protection for homeowners. The basic licensed contractor's bond is set at $7,500.[10] Material and equipment suppliers are not licensed, and provide no bond.[11] Minor works contractors (under $500) are not required to be licensed.[12] The amounts appear to be a minimum barrier to entry into the construction business. Contractors who get in trouble will have claims and unsatisfied obligations far exceeding these low amounts.[13]

License bonds at lower amounts do not need to be underwritten and are economically feasible to the surety companies because of the number of bonds written. An increase from $7,500 to $10,000 would probably not require additional underwriting, and would raise home improvement contractor license fees to the level set in 1994 for swimming pool contractors.

Eight years ago the general license bond was raised from $5,000 to $7,500.[14] Adjusted for inflation, this amount would be over $8,600 in 2000 terms. The original license bond amount in 1964 was $1,000, equivalent to about $5,400 in 2000 terms. The $2,500 increase proposed by one commentator[15] would be more than double the adjustment that would be needed to keep pace with inflation, but there is no magic number, and if the 50% increase was justified in 1994, another 33% increase now is probably not out of line. It should be remembered, though, that any Commission proposal to increase the license bond would not take effect until 2003 at the earliest. The Lumber Association of California and Nevada has proposed raising the license bond to $20,000.[16]

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10. Bus. & Prof. Code § 7071.6 (swimming pool contractors need a $10,000 bond).

11. See Bus. & Prof. Code § 7052.

12. Bus. & Prof. Code § 7048.

13. See, e.g., Memo 2000-47 Supp. 1 Ex. p. 11 (Gallagher letter giving examples of four double payments from one contractor bankruptcy ranging from $49, 254 to $170,425).

14. 1994 Cal. Stat. ch. 26, § 206.7.

15. See Memo 2000-37 Ex. pp. 7-8 (Abdulaziz).

16. See Memo 2000-37 Supp. 2 p. 4.

Pros. Increasing the license bond amount for home improvement contractors to $10,000-15,000 or even higher should be relatively simple and would not impose a significant cost on licensed contractors. It might also discourage some unworthy individuals from entering the ranks of contractors.

Cons. Existing levels are nearly meaningless as funds for homeowner protection. They are minuscule compared to the potential liability of a contractor who defaults on a number of jobs. Raising the amount high enough to provide a meaningful fund for recovery of double payments would impose costs on all contractors, even though they are not at risk. If the amount is set too high, worthy contractors would not be able to qualify because sureties would impose greater underwriting requirements above a certain level. This, in turn, would increase the percentage of unlicensed contractors and subcontractors operating in the underground economy.

Stepped License Bonds

A general approach to making license bonds more effective would be to provide for step increases in the amount, depending on how much business the contractor does annually in the home improvement field.

Pros. Stepbonding scales the license bond protection more appropriately to the volume of business, giving a larger fund to compensate those injured by contractor violations or failures.

Cons. License bonds will not likely be sufficient to cover the double payment losses when a contractor, large, medium, or small, goes bankrupt or abandons a number of projects leaving subcontractors and suppliers unpaid.

Liability Insurance

All licensed contractors (or only home improvement contractors) could be required to maintain a $100,000 general liability insurance policy.[17] The Department of Insurance has argued that the contractor's license bond is an "illusory" protection and that the public is mislead into thinking they were protected by the bond when they could rarely recover.[18]

Pros. Liability insurance would relieve pressure on the bond, leaving a greater fund for dealing with double payment problems. Insurance requirements might help improve the overall integrity of the contractor pool, leading to better consumer protection.

Cons. It isn't clear how liability insurance would address the double payment problem. Low-volume contractors might not be able to afford the insurance.

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17. See Memo 2000-37 pp. 8-10 (discussing background of insurance proposal in one version of SB 1524 (Figueroa) in 2000 legislative session); *Id*. Ex. p. 8.

18. See Senate Committee on Business and Professions Consultant's Analysis of SB 1524, as amended April 3, 2000.

Joint Checks

Joint checks issued to the prime contractor and subcontractor (or some other combination of potential lien claimants) are a recognized means for attempting to avoid double payment problems.[19] Joint checks are not certain, however, even if the release form requirements of Civil Code Section 3262 are met, because endorsement may take place without any payment from the co-payee, or the check back to the endorser may bounce, leaving the lien claimant unpaid.[20]

Joint checks should work as a way of making sure that the joint payees, by their endorsements, signify that they have been paid the amount due in agreed proportions under their contract. Common sense dictates that a subcontractor should not be able to endorse the check and then come after the homeowner if the prime contractor does not actually pay the subcontractor. The subcontractor, as a responsible businessperson, can take whatever protective steps are needed or assume the risk of nonpayment. To endorse a joint check and give a release, and then assert lien rights following nonpayment makes no sense. Regardless of whether the release form mechanism is fixed generally,[21] endorsement of a joint check by a licensed contractor or a material supplier should act as a complete release to the extent of the payment. In Arizona, when a material supplier endorses a check he "will be deemed to have been paid the money due him, up to the amount of the joint check so long as there is no other agreement between the owner or general contractor and the materialman as to the allocation of the proceeds."[22]

Pros. Joint checks are simple to implement and, if they work correctly, easily understood by the parties. If bolstered by a rule making endorsement equivalent to release pro tanto of mechanic's lien rights, joint checks could be emphasized in notice forms required to be given the homeowner and provide an easy way to avoid double payment problems in simpler projects.

Cons. Joint checks probably can't be made mandatory, so unsophisticated or misled homeowners will fail to take advantage of the improved joint check option. In a more complex project, joint checks would become burdensome, since the

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19. This approach was recognized in Bentz Plumbing & Heating v. Favalaro, 128 Cal. App. 3d 145, 151-52, 180 Cal. Rptr. 223 (1982); see also Post Bros. Constr. Co. v. Yoder, 20 Cal. 3d 1, 569 P.2d 133, 141 Cal. Rptr. 28 (1977); Re-Bar Contractors, Inc. v. City of Los Angeles, 219 Cal. App. 2d 134, 32 Cal. Rptr. 607 (1963); Crystaplex Plastics, Ltd. v. Redevelopment Agency, 77 Cal. App. 4th 990, 92 Cal. Rptr. 2d 197 (2000) (forged endorsement); Acret, *Representing the Prime Contractor*, in California Mechanics' Liens and Related Construction Remedies § 7.43 (Cal. Cont. Ed. Bar, 3d ed. 1999) ("Because of the 1993 revisions to [Civil Code Section 3263], it is doubtful that mere endorsement of a joint check constitutes a release of lien, stop notice, and bond claims.").

20. See also Memo 99-85, Hunt Report Pt. 1, pp. 13-16 (releases).

21. See, e.g., Memo 2000-78 Ex. 1-2 (Acret proposal on release forms).

22. See case cited in G. Lefcoe, Real Estate Transactions 1050 n.25 (1993). For additional discussion of joint checks, see Memo 2000-26 Ex. 1 (Loumber); Memo 2000-37 Ex. 24 (Gallagher). For language concerning joint checks in the "Notice to Owner," see Memo 2000-9 Ex. pp. 34, 36; Memo 2000-37 Ex. p. 12.

owner would have to write a large number of checks to cover each subcontractor. The protection would break down when sub-subcontractors and lower-tier suppliers are involved. It may even be difficult to write a joint check to the contractor, subcontractor, and supplier without creating difficulties. Contractors will discourage joint checks and influence homeowners to forgo this option.

Reallocating the Risk

The market functions most efficiently if risks associated with doing business are allocated rationally. The party to a transaction should have a reasonable way to assess and allocate risk, and the assumption of a level of risk should be compensated fairly. The mechanic's lien provides a mechanism for shifting the risk that would normally fall on the subcontractor or supplier to the homeowner. It is difficult, time-consuming, or expensive for the homeowner to effectively minimize the risk. The subcontractor and supplier, on the other hand, who should be more knowledgeable and experienced in these matters, and who can spread the risk over a number of jobs, are enabled by the mechanic's lien to forgo the usual degree of care expected in commercial transactions. Blind reliance on mechanic's lien rights tempts subcontractors and suppliers into not using standard credit practices, since they can always rely on the lien (which, in fact, may turn out to be worthless).[23]

Some of the more interesting proposals address this problem head-on by making structural adjustments that would invoke normal market functions to correct the double payment problem, as well as the associated problem of subcontractors and suppliers simply not getting payment at all.

Direct Pay

Subcontractors and suppliers would not have lien rights unless they request payment directly from the owner. This simple concept puts the responsibility for assessing and assuming risk on the subcontractor or supplier where it logically belongs. They would choose whether to rely on the creditworthiness of their customer, or request direct payment in order to preserve lien rights. The underlying assumption of the direct pay concept is that subcontractors and suppliers would be in a position to make a rational assessment of their customer's reliability and decide whether to assume the risk of failure or nonpayment by their customer. If they are not comfortable assuming that type of business risk, they can follow the direct pay procedure or do what the current system expects the inexpert homeowner to do — i.e., resort to joint control or bonding protections or fashion some other type of business-based remedy.[24]

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23. See also Memo 2000-9 Ex. p. 1 *et seq*. (Honda analysis of mechanic's lien marketplace in connection with ACA 5 and AB 742); Memo 2000-9 Supp. 2 Ex. pp. 15-18 (Acret).

24. For proposals and commentary on the direct pay approach, see Memo 2000-37 pp. 13-18; *id*. Ex. pp. 19-25 (Gallagher); Memo 2000-37 Supp. 2 Ex. pp. 1-2 (Gallagher); Memo 2000-47 p. 1; *id*. Ex. pp. 1-3

Pros. Subcontractors and suppliers are in a far better position than the homeowner to judge the contractor's reliability and fiscal soundness. They are far more likely to have an ongoing relationship with their customer, so that direct pay shouldn't be required. This approach makes the home improvement construction market more rational.

The confusing preliminary notice becomes unnecessary under the direct pay scheme. In the usual case, where the subcontractors and suppliers are content to rely on their customer, the homeowner is spared the blizzard of notices and may pay the prime contractor as progress payments fall due without further worries.

If a subcontractor or supplier decides to use the direct pay option, the resulting notice would make more sense because it would apply to a concrete situation and describe an action to be taken.

Cons. Permitting subcontractor and suppliers to request payment directly from the homeowner disrupts the relation between the prime contractor and the subcontractor and other business customers. By choosing direct pay, the subcontractor is saying that the prime contractor isn't financially reliable. It also has the potential of exposing the prime contractor's mark-up to the homeowner, which presumably the prime contractor would not want.

At least one representative of material suppliers remarked at a Commission meeting that they would routinely give direct pay notices to protect their lien rights as a standard practice, rather than rely on the creditworthiness and reliability of their customer. In effect, they reaffirm the notion that the mechanic's lien right is the basis of construction project financing in the home improvement context.

On the other hand, another commentator argues that subcontractors and suppliers would not dare ask for direct payment if they wanted to get work again in the home improvement business. There would be a blacklist of subcontractors and suppliers that exercised the direct pay option, so that prime contractors as a group would be unwilling to give business to them.[25]

Payment Defense

A homeowner's full payment in good faith to the prime contractor could be recognized statutorily as a defense against further mechanic's lien claims from anyone not in privity with the owner.[26]

(staff draft statute); Memo 2000-47 Supp. 1 Ex. pp. 12-13 (Abdulaziz); Memo 2000-78 Ex. pp. 9-13 (Gallagher).

25. See Memo 2000-78 Ex. pp. 4-5 (Streltzer).

26. See Memo 2000-9 Supp. 2 Ex. p. 15; Memo 2000-26 pp. 12-14; Memo 2000-37 pp. 10-12; see also Memo 2000-37 Supp. 1, Ex. pp. 3-4 (Moss); Memo 2000-47 Supp. 1 Ex. p. 13 (Abdulaziz); Memo 2000-63 Supp. 1, Hunt Report Pt. 3, pp. 2-3.

The proposal addresses the double payment problem head on, protecting good faith owners from the possibility of having to pay subcontractors or suppliers for amounts that have been paid under the contract terms.[27]

This is in line with New York law, which limits the lien to the unpaid amount:

> If labor is performed for, or materials furnished to, a contractor or subcontractor for an improvement, the lien shall not be for a sum greater than the sum earned and unpaid on the contract at the time of filing the notice of lien, and any sum subsequently earned thereon. In no case shall the owner be liable to pay by reason of all liens created pursuant to this article a sum greater than the value or agreed price of the labor and materials remaining unpaid, at the time of filing notices of such liens ….[28]

What should a subcontractor or supplier do to protect its position under this rule? The simplest approach would be to give notice to the owner so that payments can't be made "in good faith" to the contractor. This does not settle the issue, though, since it doesn't tell the parties what they should do next. One option would be to provide a mechanism for giving the direct pay notice, so that the subcontractor or supplier who has not been paid can not only hold up further discharging payments to the contractor but also ask to be paid directly. Other provisions may also be necessary to implement this type of rule.

Pros. Providing a defense where payment has already been made under the contract terms and applicable statutes is a simple, efficient rule, consistent with contract principles. The rule conforms to normal expectations. It places the risk where it belongs: on parties in the best position to manage the risk of doing business.

Cons. Smaller subcontractors and suppliers would be at the mercy of contractors and owners. Litigation would be necessary to determine whether the homeowner had paid in good faith and not in collusion with the contractor.

Privity Requirement

Returning the law to the era before enactment of the "direct lien" in 1911, this proposal would grant lien rights only where there was a contractual relationship between the owner and the claimant. This approach is even simpler than the full payment defense because it would prevent attachment of the lien in the first place and would not depend on good faith payments to the prime contractor. (The

27. For historical background and constitutional issues, see Memo 2000-26 generally (staff analysis); Memo 2000-26 Supp. 1 (Abdulaziz); Memo 2000-9 Supp. 2 Ex. pp. 6-14 (Honda).

28. N.Y. Lien Law § 4 (Westlaw 2000).

concept underlying a privity requirement could also be implemented statutorily as part of the direct pay proposal discussed above.)[29]

Pros. This is a simple approach based on familiar contract principles. In reaction, subcontractors and suppliers could be expected to create a clearinghouse of information on reliable contractors and would use other mechanisms to protect their interests and ameliorate the risk of doing business. The marketplace would respond by developing appropriate mechanisms as in other fields of commerce.

Cons. Requiring privity would be an additional burden on subcontractors and suppliers to deal with the owner. The owner presumably wants the prime contractor to deal with the subcontractors and on down the construction pyramid, or the owner would not have wanted the services of the prime contractor in the first place.

Recovery and Reimbursement Funds

About 15 states have some sort of general recovery fund protecting homeowners from double payment "damages." Two states (Utah and Michigan) have funds protecting lien claimants. Comments at past meetings suggest that these funds are not fiscally sound, or that they do not provide sufficient reimbursement to substitute for the mechanics lien right[30] Some suggest that funds in other states are not fiscally sound or are not adequately paying claims (or both).[31]

Lien Reimbursement Fund

Unpaid liens or lienable claims would be compensable from a fund administered by a state agency, financed by some type of assessment on contracts or contractors. A recovery fund also necessarily entails the cost and delays inherent in any bureaucratic solution. This approach was proposed in bills introduced by Assembly Member Honda in the 1999-2000 session.[32] A critical factor in setting up a reimbursement fund is who pays into it and the amount of the assessments. A $200 annual fee from each home improvement contractor was set out in AB 2113 in the 1999-2000 session. CSLB estimated that this would generate a $50 million fund.

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29. See Memo 2000-63 Supp. 1 pp. 1-2 (Acret proposal). For historical background and constitutional issues, see Memo 2000-26 generally (staff analysis); see also Memo 2000-26 Supp. 1 (Abdulaziz); Memo 2000-9 Supp. 2 Ex. pp. 6-14 (Honda).

30. See, e.g., Memo 2000-9, Hunt Report Pt. 2 Ex. pp. 19-22 (CSLB staff analysis); Memo 2000-9 Supp. 2 Ex. p. 4 (Gallagher); Memo 2000-9 Supp. 2 Ex. p. 18 (Acret); Memo 2000-26 pp. 11-12.

31. See also CSLB, *Analysis of State Recovery Funds*, (July 1999, 98 pp.; rec'd Feb. 7, 2000, file H-820).

32. See AB 742, in Memo 2000-9, Hunt Report Pt. 2 Ex. pp. 3-5; *id*. pp. 6-17 (Assembly Judiciary Committee analysis of AB 742); *id*. pp. 19-22 (CSLB staff analysis); Memo 2000-9 Ex. pp. 1-14 (supporting documents on AB 742); AB 2113 in Memo 2000-26 Ex. pp. 7-16.

Directly related to the issue of assessments is the issue of who can claim compensation from the fund and the standard for qualifying. The staff has not investigated the range of options, but could do so if the Commission decides to pursue this type of remedy.

Pros. A fund can protect victimized homeowners and subcontractors and suppliers without drastically revising the mechanic's lien law or imposing new requirements on the parties. A $200 annual fee from contractors is nominal and provides full protection for the small percentage who need it. Although costs will presumably be passed on to homeowners, any individual's share should be nominal.

Cons. All contractors have to pay to indemnify a lien claimants and few homeowners who didn't protect themselves. The assessment, if paid by licensed contractors, will benefit suppliers who don't pay into the fund. The assessment would have to be large enough to compensate the intended beneficiaries, but also the bureaucracy necessary to administer the fund. A fund would not rectify problems in the home improvement marketplace and would not stop irresponsible contractors from stiffing subcontractors and suppliers. In fact, it might provide more leeway, since the fund would be another source of compensation, in addition to the homeowner's property, to satisfy claims of subcontractors and suppliers who are already doing an inadequate job of checking on the creditworthiness of their customer and taking appropriate steps to spread their business risks.

Homeowner's Relief Recovery Act

Homeowners who pay twice to satisfy mechanic's liens (or who are subject to lien claims for payments already made) would have recourse to a fund created by an assessment on building permits. This proposal, fashioned by Prof. Kelso and the Institute for Legislative Practice, addressed the funding issues of a "Contractor Default Recovery Fund" by proposing an assessment collected through the building permit process.[33]

Payment Bonds

Commission discussions of bonds have been limited to payment bonds covering the cost of labor and materials already supplied, not performance bonds covering the cost of completion of the project. The intention is to limit the cost of any mandatory bonding requirement and substitute some kind of bond for the lien claim against the owners property. Bonding has come up a number of times in prior materials.[34]

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33. See Memo 2001-18 Supp. 1. Prior drafts were included in Memo 2000-47 Supp. 1 Ex. pp. 1-10, and Memo 2000-78 Supps. 2 & 3. See also Memo 2000-78 Supp. 5 pp. 1-2 (CAR).

34. See Memo 2000-9, Hunt Report Pt. 2, pp. 6-10, ; Memo 2000-9 Ex. 9-11 (Honda); Memo 2000-26 pp. 8-10; Memo 2000-78 Supp. 1 Ex. p. 1 (Wayson).

Several types of bonding options exist under current law and practice: performance bonds, payment bonds, release bonds, etc. A contractor can get a payment bond to cover payments to subcontractors, for example. 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. Civil Code Sections 3235-3236 provide protection against lien claimants where a bond in the amount of 50% of the contract price is recorded, along with the contract, before work commences. But on small projects and in the home improvement area, bonds are not a practical option. The cost of a bond can be 1-5%, some subcontractors may have difficulty qualifying, and human nature is to avoid the trouble and expense of a bond until it is too late. Mandating payment bonds would add to the paperwork and expense of home improvement contracts.

As to payment bonds, Prof. George Lefcoe points out that

> 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.[35]

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."[36]

The Nolo Guide on mechanic's liens gives little attention to payment bonds, since they are "not a viable option for most small property owners." As to the recorded contract and bond under Section 3235, the Nolo Guide advises:

> 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.[37]

Mandatory Full Payment Bond

Prime contractors could be required to get payment bonds in the full amount of the contract price to engage in the home improvement business. Recovery against the bond would substitute for the lien. Bonds of this amount would set a high

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

36. *Id*. § 102.02(a)(2)(iv), at 562.

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

standard for contractors because they are underwritten by surety companies, which conduct a careful review of the financial soundness, capacity, and character of the contractor before issuing a bond. A cap on the principal amount of the bond could be set to make the bonds more affordable and to save costs for homeowners.

Pros. Bonds are routine in public works. Bond premiums should go down if the volume of business for sureties increases through a mandatory bonding requirement.

Cons. Bond premiums would add significantly to the cost of the project, particularly in the smaller home improvement market. Some percentage of worthy contractors would not be able to qualify for the bond. Mandatory bonding would be hard to police, because the rogue contractor who is most likely to need the bond is also most likely to ignore the bond requirement.

Mandatory 50% Payment Bond

Prime contractors would get payment bonds in the amount of 50% of the contract price for contracts not exceeding $25,000 (or some other appropriate level), which would substitute for the lien. This is an option under existing law, but is probably little known and rarely used in home improvement contracts.[38] An unresolved issue from the Commission's earlier consideration of this proposal is whether the mandatory bonding requirement would apply only to contracts under a certain amount or to the first $25,000 of all home improvement contracts.[39] The threshold amount should be set to cover the bulk of cases where experience shows there have been the most double payment problems (assuming we can get relevant figures from CSLB or some other source).

Pros. The mandatory 50% payment bond adopts a known feature of existing law. It is a minimal intrusion in normal business practices. The amount of the bond would be low ($12,500) so that bonds could be issued routinely with commensurably low premiums. While this approach would not be a complete fix, it should address some of the most common cases, such as roofing contractors where abuses are occurring. Providing a minimal bond at a low cost should also improve acceptability in the industry, leading more contractors to comply with the requirement than a more draconian approach.

Cons. The homeowner would end up paying the extra cost of the bond and the protection may be too limited ($25,000). Past bonding schemes exempted lower priced contracts because it was inefficient to impose bonding in these cases; this proposal turns that learning on its head. If the requirement only applied to contracts under $25,000, the larger, sounder contractors would not be subject to the burden and expense of the bond and homeowners wouldn't be protected.

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38. See discussion in Memo 2000-63 pp. 1-12 & Ex. pp. 1-3; Memo 2000-63 Supp. 1 pp. 3-4 (Hunt).

39. See Memo 2000-63 Ex. p. 2; Memo 2000-63 Supp. 2 (Hunt).

Blanket Payment Bond

Home improvement contractors would be required to provide a blanket payment bond (not a performance bond) of $50,000 or some other amount as an adjunct to the license bond, to provide a degree of protection against double payment liability by homeowners. This would not be a bond on each project, but a single payment bond, similar in concept to the license bond, but covering all projects the licensed contractor undertakes. Failure to maintain this bond would be equivalent to failing to satisfy licensing requirements.[40]

The blanket payment bond could also be stepped up depending on how much business the contractor does in a year.

Pros. Blanket bonding in a relatively modest amount should not be too expensive. If mandated in the home improvement industry, the cost and threshold qualifications should drop as a result of economies of scale. Raising standards for home improvement contractors might be helpful in weeding out the more irresponsible and financially precarious contractors.

Cons. A bond in this amount would have to be underwritten and would not be issued by surety companies on a routine basis. This raises the cost and would prevent entry into the business of contracting.

Lien Bond Between Contractor and Subcontractors-Suppliers

A "line of credit" form of bond could be created to protect payment to the subcontractors and suppliers where the prime contractor is paid but fails to pay the others. This type of bond should be very inexpensive because of its limited nature and small risk to the surety.[41] This lien bond would not be mandatory, because of the concern about driving worthy but unbondable contractors out of the market or underground. It is coupled with a direct pay feature (discussed above), giving subcontractors and suppliers a way out where the contractor can't get the bond and they are not willing to extend credit. Lien rights would continue until the homeowner pays and 20-day preliminary notices would not be necessary.

Escrows and Withholding

Joint Control

The services of a joint control company are available under existing law. Contractors on home improvement projects could be required to use escrow accounts to process payments and releases. A joint control scheme should have the following features:[42]

- *Mandatory*. The joint control would have to be mandatory, or very difficult to waive, if it is to have its intended effect of protecting consumers. If a job

40. See Memo 2000-37 p. 7 & Ex. p. 7.

41. See Memo 2000-78 pp. 9-10; *id*. Ex. pp. 9-13 (Gallagher).

42. For more detail, see Memo 2000-78 pp. 3-5.

is bonded or 50% bonded, that would probably be a sufficient substitute remedy.

- *Threshold*. Contracts below a certain amount should not be subject to the joint control requirement because the protection is too costly in light of the risk. We don't know the right amount, but something like $5,000 or even $10,000 seems appropriate.
- *Prime contractor responsibility*. The prime contractor would be required to set up the joint control with a licensed joint control agent and inform subcontractors and suppliers dealing directly with the prime contractor of the joint control account. The prime contractor would also inform the control of all parties contracting with the prime.
- *Subcontractor and supplier responsibility*. Parties in privity with the prime contractor will need to make sure that there is a joint control account in place. A mechanism would need to be set up so that sub-subcontractors and suppliers furnishing to subcontractors get information on the joint control account, since they will submit claims to the control.
- *Homeowner responsibility*. Joint control system relieves much of the burden on homeowners. Payments would need to be made in a timely fashion to the joint control agent, but no other special action would be needed unless the homeowner wanted to use some other approved substitute remedy such as a bond.
- *Enforcement*. The duties of licensed contractors would be enforceable by CSLB, and joint control companies are subject to the authority of the Commissioner of Corporations. But the major enforcement mechanism would be parties wishing to be paid expeditiously being sure the joint control was in effect and owners wishing to avoid mechanics liens making sure payments are properly made.

Pros. Joint control agencies exist now and are used in larger projects, so it is not necessary to reinvent the wheel. The fees should be lower if there is more volume of business. Use of escrow in real estate transactions and refinancing is presumed; it is not too big a step to apply a simple escrow system to home improvement contracts. Joint control companies are bonded, providing additional protection. The mechanism will benefit subcontractors and suppliers by making sure they get timely payment. Properly implemented, a joint control scheme should cut down on the paperwork of everyone concerned.

Cons. It isn't known what the cost will be or how the market will respond, so fees could be higher than envisioned. As with all across-the-board schemes, all homeowners would end up paying to set up a scheme to compensate for the few bad-apple contractors. Some contractors, in order to save time and submit a lower bid, might also ignore the joint control requirement and evade the statute.

Check-Writing Service

Described as a simplified and cheaper alternative to joint control, the check writing service would be a neutral party who would match releases with payments. One commentator described the concept as follows:[43]

> We would suggest a new procedure that would not require a bonded joint control company but merely a check writing service of some sort. That procedure would be to assure, to the extent possible, that there are no liens on the project. The company proposed would not need to be a joint control company. It would not need to actually hold any of the funds. What it would do is obtain appropriate releases from every one who had given preliminary notices, and before allowing an owner to make any payment, the proposed company would secure a release executed. The release would then be held by the service and a check prepared by this service would be written which would be signed by the owner. With our present state of computer technology, we believe that this type of service would be nominal in cost.

This type of service is presumably available now and is probably available through Internet services. Check writing services have not been investigated in any detail, but the staff's limited discussions with two joint control agencies suggest that, at least in the Bay Area, the described level of service is what one would get from a joint control agency in home improvement contracts.[44]

Pros. The check writing service is envisioned as a cheaper alternative to joint control agencies, because they would not need to be bonded like joint control agencies and would not do inspections.

Cons. If check writing services aren't bonded, wouldn't there be a risk that they would not be reliable and could abscond with the owner's money? What if they are careless in matching checks to releases, so that the money is paid without there being a proper lien release? The homeowner could still be subject to the double payment risk, with no added protection.

If a new statutory procedure is to be mandated, it should significantly reduce or eliminate the risk of double payment, as well as the parallel problem of subcontractors and suppliers not getting paid by defaulting prime contractors. Otherwise, the expense and effort of imposing a new statutory scheme will not be justified. The cost of a service goes up as the risk is transferred.

Retainage

The retainage approach delays payment of a percentage of the contract price (e.g. 10% or 25%) for a period such as 30 or 60 days to clear lien claims. Retention may be based on a percentage of each payment or the last 10% or so of the entire contract amount. The prime contractor would have the option of bonding as a substitute for the retainage, and thus accelerate final payment or permit full

43. See Memo 2000-37 p. 7 & Ex. p. 7 (Abdulaziz proposal).

44. See Memo 2000-78 pp. 5-7.

payment of all progress payments when due.[45] California has detailed statutes on "retention proceeds," progress payments, and prompt payment that would have to be revised.[46] Unless retainage is mandated for certain types of contracts, it would not address the double payment problem, since it arises where the owner has not retained payments. For example, in Texas, the owner is required to retain 10% of the contract price of improvements until 30 days after completion.[47] The lien claimant has a lien on the retainage by sending proper notice and filing an affidavit within 30 days after completion.[48] Early California law required 25% of the contract price to be retained.[49]

Pros. Retainage is simple to administer from the owner's perspective (as well as that of the lender). Holding 25% of the contract price for a short period would cover many potential double payments, though not major contractor failures. Contractors who wanted to be paid in full before the retainage period expired would be able to substitute a bond or avoid retainage by setting up joint control, which would continue the protection afforded the owner. Contractors would have an incentive to make sure subcontractors and suppliers were paid so that they could get complete payment promptly.

Cons. Contractors object to even a 10% retainage scheme that the retained amount is greater than their net profits, which are often less than 5%, thereby forcing them to provide credit (or defer paying subcontractors and suppliers) until final payment.[50] Contractors become involuntary financiers of an unacceptable portion of the project. This would force them to use bonding or joint controls, with the attendant cost to the homeowner. Retainage is difficult to enforce, because it involves payments the homeowner makes to the contractor, and the homeowner may not understand what to do. Homeowners can be influenced to "save money" by paying without the retention.

Miscellaneous

Consent to Lien

Since the homeowner's property will be subject to the lien, the law could require specific consent to imposition of a mechanic's lien. Without consent, the subcontractor or supplier would not have a direct lien against the home and payment to the prime contractor would protect the homeowner.[51] The Missouri mechanic's lien statute adopts a consent requirement for certain residential

45. See Memo 2000-26 p. 11.

46. See Civ. Code § 3060 *et seq*.; see also Bus. & Prof. Code § 7159 (home improvement contracts).

47. Tex. Prop. Code § 53.101 (Westlaw 2000).

48. *Id*. §§ 53.102, 53.103.

49. See Memo 2000-36 p. 12.

50. See, e.g., Kirksey & Maute, *Moneymoneymoney: Legal and Ethical Dilemmas in the Construction Payment Process*, 16 Construction Law. 3, 4 (January 1996).

51. See Memo 2000-26 Ex. p. 3 (Loumber).

improvement contracts,[52] but it appears that one blanket consent can be obtained by the prime contractor covering all subcontractors and suppliers. An alternative would be to require each potential lien claimant to obtain a consent in response to a preliminary notice or other form of paper given the homeowner by subcontractors and suppliers.

Pros. Consent would potentially provide a type of privity and would help focus the homeowner's attention on the issue of potential double payment liability. Assuming that a blanket consent could not be given to the prime contractor in satisfaction of the consent requirement, the consent would have some of the same potential benefits as other proposals that would encourage subcontractors and suppliers to assess their real risk and consider the creditworthiness of their customer. It would not have the disruptive potential some see in the direct pay proposal, since the flow of payments would still be through the prime contractor and down the pyramid.

Cons. Consent will just be another piece of paper that the homeowner signs without knowing its significance. It will add another burden on subcontractors and suppliers to get the signature of the owner and maintain another paper in the files.

Criminal Sanctions — Lien Fraud

The prime contractor's failure to pay subcontractors and suppliers, as well as the subcontractor's failure to pay sub-subcontractors and suppliers, could be criminalized.[53] It is generally recognized, however, that most cases of double payment do not involve criminal conduct, but incompetence, carelessness, overextension, and other factors that lead to insolvency. Unless the criminal sanction would act as a significant deterrent, it would do nothing to aid homeowners faced with double liability where a contractor defaults.

We also suspect that California law provides some general remedies that should be, but presumably are not, deterring irresponsible practices by contractors.

GENERAL REFORM ISSUES

The mechanic's lien statute has been amended 66 times just since its recodification in the Civil Code in 1969. That revision and the 1951 revision before it, largely continued pre-existing language. The process of accretion has taken its toll on a body of law that was labeled "confused and confusing" in 1915.[54]

Commentators predictably have different views on the soundness of the existing statute. At its first meeting discussing mechanic's lien issues, several speakers urged the Commission to "go back to square one" and conduct a thorough review

52. Mo. Ann. Stat. § ____.

53. See Memo 2000-26 Ex. p. 4 (Loumber); Memo 2000-78 Supp. 1 Ex. p. 3 (McSweeny).

54. Roystone Co. v. Darling, 171 Cal. 526, 546, 154 P. 15 (1915) (Henshaw, J. concurring).

and revision of the mechanic's lien law and related provisions, which are confusing, complicated, and out of step with modern conditions. Others argued that, while there are some improvements that could be made, the statute is basically sound and represents the accumulated improvements from many years' work.[55]

Drafting Approach

The Commission has started the process of redrafting the mechanic's lien law. This is likely to be an extended project because many provisions date back decades or even into the 1800s. While there is a strong argument that the mechanic's lien law is in such a sorry state that it would be better to start with a clean slate,[56] the Commission has concluded that it would be better to start with the existing statute and revise it in place. The Commission is concerned that it would not be productive to become mired in a lengthy comprehensive revision of the mechanic's lien law that ultimately could not be implemented. A consensus on the need for reform is easier to build by a detailed review of the existing statute, than by throwing it out and starting from scratch.

The Commission's past experience in revising major statutes supports the conclusion that stakeholders and other interested persons can profitably work together on an overall revision by taking the existing law apart on a section-by-section basis and putting it back together with useful reforms. By modernizing the drafting, eliminating archaic and unnecessary language, reorganizing and simplifying the structure of the statute, and using shorter, clearer sections, the statutes can be greatly improved even if no major substantive changes are made.

In addition, a simpler and better-organized statute then provides a better platform for making needed substantive changes in future years.

Cleaning up General Definitions

The definitional provisions in the mechanic's lien statute are in terrible shape. For example, Civil Code Section 3097, purporting to define preliminary 20-day notice (private work), is the longest section in the mechanic's lien statute. In fact, it is twice as long as the entire mechanic's lien statute in the 1872 Code of Civil Procedure. Section 3097, amended over 15 times since 1969, is a mini-practice

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55. See Minutes of November 1999 Meeting.

56. See, e.g., James Acret's "Draft of Simplified Mechanic's Lien Statute" attached to Memo 2001-41, Ex. pp. 1-7. For reactions to this proposal, see Memo 2001-41 Supp. 1 (Gordon Hunt) & Memo 2001-41 Supp. 2 (Sam Abdulaziz). Mr. Acret has described the mechanic's lien statute as an "unruly beast that cannot easily be beaten into submission. This writer believes that the mechanics lien statute should be rewritten from scratch rather than redlined. That approach got us to where we are now!." See Letter from James Acret to Stan Ulrich, May 17, 2001 (Memo 2001-53, Supp. 1, Ex. p. 2). On the other hand, Rodney Moss writes that the "problem is that an enormous case law has developed over the years based upon the mechanic's lien law as drafted and those clarifications have become part of the lien law. I do not believe the history of the lien law can be disregarded in any attempt to update and refine the lien law." See Letter from Rodney Moss to Stan [U]lrich, May 18, 2001 (Memo 2001-53, Supp. 1, Ex. p. 3).

guide containing substantive and procedural material that should be relocated with related substantive sections. Many other supposed definitions are really substantive rules that should be integrated with related provisions.[57]

Some terms are defined and never used, such as "materialman" (Section 3090) and "subdivision" (Section 3105). Others are defined, but largely ignored in later provisions, such as "site" (Section 3101), which is ignored in favor of references to land, real property, or jobsite. Some are defined and used only once, such as "notice of nonresponsibility" (Section 3094). Archaic language, such as the references to flumes and aqueducts in the definition of "work of improvement" (Section 3106) should be eliminated or subsumed in general language.

Public Contracts

There is no mechanic's lien right in public works.[58] Mandatory bonding and the stop notice remedy provide protection for contractors, laborers, and suppliers on public construction projects. A general body of law concerning stop notices and payment bonds in public works is contained within the mechanic's lien law in the Civil Code.[59] The Commission is considering separating the public and private construction provisions by removing the public works sections from the Civil Code mechanic's lien statute.

In 1982, the Public Contract Code was created. The new code pulled sections together from a number of other codes, including the Education Code, Government Code, Streets and Highways Code, and Water Code. Public Contract Code Section 100 of the Public Contract Code reads, in part: "The Legislature finds and declares that placing all public contract law in one code will make that law clearer and easier to find."

Contractor and supplier remedies relating to public construction contracts go hand in hand with the provisions governing the contract terms and bidding process. Under the existing scheme, the stop notice procedure seems to be consolidated in the Civil Code, but there are many other bond provisions in the Public Contract Code and probably elsewhere.[60]

Completion Issues — Senate Bill 938

Consideration of Senate Bill 938 (Margett), relating to giving notice of completion, has been deferred by the Assembly Judiciary Committee pending receipt of the Commission's report.[61] This bill would require the owner, within 10

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57. See, e.g., Civ. Code §§ 3083 (bonded stop notice), 3084 (claim of lien), 3092 (notice of cessation), 3093 (notice of cessation),

58. See, e.g., Civ. Code § 3109 ("This chapter does not apply to any public work.").

59. See, e.g., Civ. Code §§ 3179-3214 (stop notices for public works — 25 sections), 3247-3252 (payment bonds for public works — six sections).

60.

61. See Assembly Judiciary Committee Analysis of SB 938 attached to Memor 2001-53, Ex. pp. 2-6.

days after a notice of completion or cessation is filed, to give notice to subcontractors and suppliers who have given a preliminary notice. Failure to do so would negate the shortening of the lien-filing period normally resulting from such filings, meaning that the 90-day period would apply. As discussed above, the Commission has not completed its comprehensive review of the mechanic's lien statute. The Commission has not considered the issues addressed in SB 938 or formulated a proposal encompassing notice of completion.[62]

Accordingly, the Commission urges the Assembly Judiciary Committee not to defer consideration of SB 938 in anticipation of the Commission's completion of a comprehensive mechanic's lien recommendation.

62. Nor does the Commission have a position on SB 938. The Commission does not advocate the passage or defeat of bills pending in the Legislature or the approval or veto of bills on the Governor's desks. See Gov't Code § 8288.